S. HRG. 100-318

SATELLITE TV FAIR MARKETING ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON COMMUNICATIONS

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 889

TO AMEND THE COMMUNICATIONS ACT OF 1934 TO PROVIDE FOR FAIR MARKETING PRACTICES FOR CERTAIN ENCRYPTED SATELLITE COMMUNICATIONS

JULY 31, 1987

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CONTENTS

	Page
Opening statement by the Chairman	1
Opening statement by Senator Gore	2
Opening statement by Senator Pressler	13
Text of S. 889	5

LIST OF WITNESSES

Bumpers, Hon. Dale, U.S. Senator from Arkansas	10
Carp, Bert, vice president, government affairs, Turner Broadcasting System	37
Prepared statement	38
Question of Senator Inouye and the answer	41
Davis, Diane Friedel, satellite dish owner	170
Prepared statement	172
Dunham, Larry, executive vice president and general manager, Videocipher Division, General Instrument Corp	142
Prepared statement	143
Letter of August 21, 1987, with questions	152
Ergen, Charles, president, Echosphere Corp	154
Prepared statement	157
Finn, Frederick W.	41
Prepared statement	43
Questions of Senator Inouye and the answers	62
Grochoski, Chet, vice president, policy administration and corporate development, Amway Corp	97
Prepared statement	98
Hobbs, Michael E., senior vice president, policy and planning, Public Broadcasting Service	188
Prepared statement	189
Mooney, James P., president and CEO, National Cable Television Assn	29
Prepared statement	30
Questions of Senator Inouye and the answers	35
Phillips, B. R., III, CEO, National Rural Telecommunications Cooperative	75
Prepared statement	78
Questions of Senator Inouye and the answers	87
Pitsch, Peter, Chief of Staff, Office of Plans and Policy, FCC	19
Prepared statement	20
Questions of Senator Inouye and the answers	27
Thomson, Robert, vice president, Tele-Communications Inc	66
Prepared statement	68
Timothy, Raymond J., group executive vice president, National Broadcasting Co., Inc	161
Wolford, David, CEO, Home Satellite Services	90
Prepared statement	91
Questions of Senator Inouye and the answers	95

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

Adair, Robin, statement	223
Denman, Robert A., director, Washington operations, National Farmers Union, letter	253
K-SAT Broadcasting, Inc., statement	221
Lightstone, Ronald, on behalf of Viacom International, Inc., statement	215
Maglio, Gerard A., Daniels & Associates, Inc., letter	132
McDonald Alan, Daniels & Associates, Inc., letter	133

Mitchell, Hon. George J., U.S. Senator from Maine, statement 209
National Telephone Cooperative Assn., statement 213
Ochs, R. D., director, antenna works, Industrial and RF Engineering Consultants, statement 217
Oliver, Doris M., statement 210
Rizer, Jordan E., Director, American Forces Information Service, DOD, letter 238
Rogers, Thomas S., vice president, policy planning and Roger L. Ogden, president, National Broadcasting Company, Inc., letter 164
Theroux, James M., CEO, Metropolitan Cablevision, Inc., statement 212
Valenti, Jack, president and CEO, Motion Picture Association of America, Inc., letter 242
Vogelsang, R. L., National Satellite Programming Network, letter 255
Wenrich, Tom, statement 220

SATELLITE TV FAIR MARKETING ACT

FRIDAY, JULY 31, 1987

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON COMMUNICATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room SR-253, Russell Senate Office Building, Hon. Ernest Hollings (chairman of the committee) presiding.

Staff members assigned to this hearing: Toni Cook and Tom Cohen, staff counsels; Katherine Meier and Gina Keeney, minority staff counsels.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. The committee will please come to order.

This morning we have S. 889 by the distinguished Senator from Tennessee, relative to the accessibility of affordable programming for dish owners or that segment in society, mostly rural America, where there is not cable.

Many of the issues that we face today were first addressed by the Committee at a hearing last year. At that time, only a few program services were scrambled, and no uniform system had been developed for making that programming available to dish owners. The FCC, the programmers, and the cable industry then assured us that market forces would resolve any concerns.

Since that hearing, the market has evolved further, and the FCC, the programmers, and the cable industry continue to tell us everything's fine. Obviously, the authors of S. 889 strongly disagree. They believe government intervention is necessary to provide dish owners with access to scrambled programming at competitive prices.

Our hearing today will explore the state of the scrambling marketplace and examine whether it is effectively competitive. Do home dish owners have access to programming at reasonable prices?

Our first panel today will address the programming market, its availability and cost. The second panel will discuss the descrambling equipment market. The last panel will address the issues arising from the scrambling of the major television networks signals, including the public broadcasting service.

I look forward to hearing from the witnesses on these and any other issues they wish to raise.

And the bottom line is that the cable folks, the broadcasters, the programmers, say the marketplace will solve all the problems; and

of course, the authors of our bill feel that the marketplace is not going to solve it and we need some government assistance, and that is the intent of S. 889.

We have this morning on the floor the fix, we call it the trigger, to Gramm-Rudman-Hollings on the budget and the debt limit. Debate started momentarily a while ago, and I have got to repair downstairs there. And I will ask our distinguished colleague from Tennessee, the author of the bill, to preside for the committee.

OPENING STATEMENT BY SENATOR GORE

Senator GORE [presiding]. Thank you very much, Mr. Chairman. I appreciate it, and I want to thank you for scheduling this hearing.

S. 889, the Satellite TV Fair Marketing Act, now has 14 co-sponsors. Senators Ford and Senator Bumpers, who have been there from the very beginning, the three of us have fought together on this for quite some time. And we have been joined by Senators Pryor, Sasser, Rockefeller, Sanford, Cochran, Bentsen, Daschle, Conrad, McConnell, Mitchell, and Burdick.

On behalf of these colleagues and on behalf of the two million home satellite dish owners throughout the country, I would like to again express gratitude to Chairman Hollings for agreeing to set up this hearing and for the cooperation of Chairman Hollings and the committee staff in helping to arrange today's hearing.

I also want to thank all of the satellite earth station owners and business people who traveled so far to be here today to watch this process in action. The extremely active and informed activity of the home dish owners fighting against huge, powerful business interests to get fair viewing rights is a tremendous example of how our democratic system ought to operate.

As many of you know, the Senate considered this issue last year. If only five Senators had switched their votes, the amendment would have passed. Many of those who voted against the amendment last year agreed that there were problems facing home satellite dish owners, but they argued that we should give the marketplace time to adjust, and they said if the problem still existed in a few months we could then take positive legislative action with their support.

The kind of action we are asking for is not government help, so to speak, but competition and government action to ensure that competition is possible.

Well, now we have had the passing of time since the vote last year, more than enough time to see that this marketplace is not going to work until the anti-competitive nature of the dominant economic interests changes.

We now need a meaningful law to ensure that home dish owners are able to buy programming at fair prices and that the ongoing effort to stifle the growth of the TVRO industry is brought to a halt.

Let us look at what has happened and what has not happened, as the case may be, since the Senate last considered satellite television scrambling. First of all, only one distributor, who is not a cable television company, has obtained any agreements of any kind

with programmers to allow it to package and distribute to TVRO owners. And those contracts with that single distributor have been few, and with none of the major program services, and with anti-competitive restrictions to boot.

The two other major would-be distributors have had absolutely no success in their efforts to get the programmers to talk to them about selling them the programs for redistribution.

Several other promising packaging businesses or distribution businesses have had to simply fold their tents without even having a chance to compete in this marketplace. Meanwhile, only one widely available package has developed, TVRO package. That is the Viacom Showtime services, once again offered by a cable-dominated company.

We had a lot of ballyhoo about the Turner Broadcasting package. Many people looked forward enthusiastically to the offering of this package. What happened? Well, the largest multi-system cable operator bought a large share of the Turner company. Immediately afterwards, the Turner package was cancelled.

Last year it was revealed that the major cable conglomerates had worked to stifle the growth of the home dish industry and to restrict program availability to dish owners. That blatant coercion has simply taken different, more subtle forms, in the implicit demand by some multi-system operators that programmers not be satellite dish friendly, as they say, in their agreements or non-agreements for dish owner distribution.

And in an even more bizarre marketplace distortion, some programmers refuse to allow even local cable companies the right to put together competitive packages to serve home dish owners.

I know many local cable companies in Tennessee who have worked hard to be fair to rural families they cannot serve with a hard wire, by trying to package and sell programming to dish owners, if only the programmers would allow them to do so.

So while MSO, or multi-system operator, corporate offices are squeezing programmers to slow down independent packaging, other programmers are squeezing local cable operators to keep them, too, out of the business of serving dish owners. Simply put, the marketplace is as anti-competitive as it was a year ago.

The case for legislation is even stronger than it was a year ago. In advocating the passage of S. 889, we are simply seeking a fair deal for home dish owners willing to pay for the same kind of services readily available in cable-served areas.

Our legislation is straightforward. A programmer under this legislation may scramble, but he must stop the kind of aggressively anti-competitive distribution practices that have characterized the industry to date and which so far show no signs of abating without our involvement.

Programmers who choose to scramble services should be willing to sell programming to home dish owners. We believe that this right of access to the marketplace is fundamental. If programmers use other companies for distribution, they must establish reasonable business standards and not discriminate among distributors who meet those standards.

And understand what the basic nature of the problem is today. The programming industry is controlled by the cable industry. The

cable industry provides their largest source of revenue. The multi-system operators provide their largest source of revenue.

And so the programmers are afraid to upset their largest customers. In most cases the programmers are owned by the cable industry.

And so, dish owners who wish to purchase services, not get it for free but purchase the programming, have no alternative except to buy it from the cable industry. And the programmers have a rule. In many cases it is an unwritten rule, but it is a rule. They will not sell to any distributor who is not owned by a cable television company.

So the marketplace for home satellite dish owners is clearly not working. It is not competitive and will not be competitive until the interlocking cable programming companies release their stranglehold on a fledgling technology that has brought the communications revolution to millions of rural families.

I am confident that today's hearing will build a strong record for S. 889. I look forward to working with our colleagues on the committee to hear the testimony today and in the near future to consider this bill for committee action.

[The bill follows:]

100TH CONGRESS
1ST SESSION

S. 889

To amend the Communications Act of 1934 to provide for fair marketing practices for certain encrypted satellite communications.

IN THE SENATE OF THE UNITED STATES

MARCH 31 (legislative day, MARCH 30), 1987

Mr. GORE (for himself, Mr. FORD, Mr. BUMPERS, Mr. PRYOR, Mr. SASSER, Mr. ROCKEFELLER, Mr. SANFORD, and Mr. COCHRAN) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

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A BILL

To amend the Communications Act of 1934 to provide for fair marketing practices for certain encrypted satellite communications.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Satellite Television Fair Marketing Act".

FAIR MARKETING OF CERTAIN SATELLITE COMMUNICATIONS

SEC. 2. Section 705 of the Communications Act of 1934 (47 U.S.C. 605) is amended—

(1) by redesignating subsections (c), (d), and (e) as subsections (d), (e), and (f), respectively; and

(2) by inserting after subsection (b) the following new subsection:

"(c)(1) No person shall encrypt or continue to encrypt satellite delivered Public Broadcasting Service programming intended for public viewing by retransmission by television broadcast stations.

"(2) No person shall encrypt or continue to encrypt satellite-delivered Armed Forces Radio and Television Service Programming, unless such encryption is required under multinational trade agreements.

"(3) any person who encrypts any satellite delivered programming for private viewing shall—

"(A) make such programming available for private viewing by home satellite antenna users;

"(B) when making such programming available through any other person, establish reasonable financial and character criteria under which distributors may qualify to distribute such programming to home satellite antenna users and not discriminate in price, terms,

or conditions among different distributors offering similar distribution services to the consumer; and

"(C) conduct such encryption in accordance with uniform standards for encryption of such programming approved by the Commission.

"(4) Standards approved by the Commission pursuant to paragraph (3)(C) of this subsection shall be designed as far as possible to provide the public interest benefits of a universal encryption system which permits decryption at the television receiver of a cable television subscriber and a home satellite antenna user.

"(5) The provisions of paragraph (3)(C) of this subsection shall not take effect until the Commission has completed a rulemaking on the standards required under this subsection.

"(6) Any person aggrieved by any violation of this subsection may bring a civil action in a United States district court or in any other court of competent jurisdiction. Such court may—

"(A) grant temporary and final injunctions on such terms as it may deem reasonable to prevent or restrain such violations; and

"(B) direct the recovery of full costs to a prevailing plaintiff, including awarding reasonable attorney fees, actual damages, any additional profits of the vio-

lator, or statutory damages for all violations in a sum of not more than $500,000 as the court considers just.

"(7) As used in this subsection, the term—

"(A) 'satellite delivered programming' means video programming transmitted by a domestic communications satellite intended for reception by cable television system subscribers; and

"(B) 'reasonable financial and character criteria' means commonly prudent business standards designed to facilitate payment to the programmer and maintenance of the business reputation of the programmer, and which are calculated to facilitate the existence of multiple noncable distributors.".

FEDERAL TRADE COMMISSION INVESTIGATION INTO PROGRAM MARKETING PRACTICES

SEC. 3. (a) The Federal Trade Commission shall conduct and complete an investigation within 120 days following the effective date of this section into the pricing and distribution terms and practices of persons selling satellite television programming to home satellite antenna owners to determine whether the market for such programming is developing competitively.

(b) Should the Federal Trade Commission determine, after such investigation, that this market is not developing competitively, it is empowered to establish any remedies

which it deems necessary to produce adequate competition for such programming.

AVAILABILITY OF NETWORK PROGRAMMING TO RURAL AREAS

SEC. 4. The Federal Communications Commission shall initiate a rulemaking to facilitate, to the maximum possible extent, the provision of network broadcasting signals to persons living outside the available broadcast area of local licensees. In undertaking such rulemaking, the Commission shall take into consideration the following:

(1) the extent to which individuals in rural areas are unable to receive broadcast television transmissions;

(2) the extent to which existing Federal rules have prevented the ability of local broadcast entities from providing signals to such persons living outside areas designated as Grade B countours by the Commission;

(3) the potential for serving these persons, and others who cannot receive such transmissions, using home antennas to receive satellite delivered network programming which might be otherwise encrypted to prevent private reception; and

(4) methods by which network programmers may protect certain portions of satellite-transmitted signals not intended for public viewing, while providing unen-

crypted signals to those persons living outside Grade B countours as defined by the Commission.

EFFECTIVE DATE

SEC. 5. The foregoing provisions of this Act shall take effect upon the expiration of the 30-day period following the date of its enactment.

Senator GORE. Does anyone else have an opening statement?

[No response.]

Senator GORE. Well, therefore we will go to the first panel of witnesses—oh, I am sorry. Senator Bumpers has arrived. I did not see you arrive. Excuse me.

Senator Dale Bumpers is our leadoff witness.

STATEMENT OF HON. DALE BUMPERS, U.S. SENATOR FROM ARKANSAS

Senator BUMPERS. Makes me wish I were a presidential candidate. I would be more conspicuous.

Senator GORE. Some of us are glad you are not.

Senator PACKWOOD. You could not be a presidential candidate. Your opening statement is not in large print.

Senator BUMPERS. I was asked to keep my statement short. I guess the committee knows my propensity for going on too long. And I will, because there is very little I can add to what you have already said, Mr. Chairman.

Two years ago, when I first became interested in this subject, Senator Goldwater was chairman of this subcommittee, and he was very strongly opposed to this legislation or any other tampering with what he considered to be market forces. And it was very difficult for any of us to argue with that proposition most of the time.

But I also recall—and I mean absolutely no disrespect, Senator McCain, to Senator Goldwater—he assured me that by the summer of 1986 decoders would be selling for $175. Now, here we are two years later, the same situation prevails today as it did a year ago, as it did two years ago.

It is just more dramatic now, and we still have one firm manufacturing decoders. They sell anywhere at the retail level from $395 to $425.

But the point should be made that, under current circumstances, if they chose to charge $1,000 for a decoder, a consumer would have no choice but to pay it or do without programming. The lack of availability of decoders is as acute now as it has ever been.

In my State, we were the biggest manufacturer of dishes of any state in the nation. We had 22 manufacturers when I appeared

here a year ago, Mr. Chairman. Today we have seven or eight, and they are just barely hanging on.

And one of the reasons they are hanging on is because decoders are not available to them, they are not available to their distributors, they are not available to the retailer, and they are not for the most part available to the consumer. At least, the consumer cannot get one from a retail dish sales shop.

We have at least 1,900,000 dishes in the country, almost 2 million.

Now, the reason Senators Gore, Ford, and I have become deeply concerned with this is because we come from rural states, and of the roughly two million dishes in the country, 1,300,000 of those are in rural areas. In my state, we have between 35,000 and 40,000 of these dishes, and virtually all of them are in rural areas.

So Mr. Chairman, our bill is very simple. I will cover it as briefly as I can. Number one, it bars public broadcasting, PBS, and Armed Services Radio and Television service from encrypting. Now, PBS says this presents a problem for them. They are planning to use stereo and do some other upgrading, and they say this could cause them some problems.

I happen to be one who strongly believes in PBS. I want it available to everyone. When I was elected governor, one of the things that I ran on was by the time I left the governor's office PBS would be available to every household in Arkansas. Unhappily, I did not meet the goal, but we had the money appropriated and that goal was achieved shortly thereafter.

And incidentally, I never address a high school or college crowd t' at I do not tell them, quit watching Dallas and Dynasty and tune to PBS. I used to include Falcon Crest, but Morgan Fairchild was in one of my committee hearings the other day, so I eliminated Falcon Crest.

But we say to PBS and the Armed Forces that, you may not encrypt except under some circumstances that FCC may allow you to do that, and at the same time not prohibit any household in this country that now gets PBS from continuing to get it.

Number two, we say to the programmers that they may choose to continue to be the sole source of the distribution of their program, this bill does not prohibit them from doing it.

But if they are going to distribute that program with anybody, it has to be on a non-discriminatory basis, under known guidelines that makes it available to any third party who wants to get into the distribution of this business.

Now, I am not prepared to say, because I do not know what other people are going to say and this is only hearsay, but I understand that people that have been trying to put together these packages and have gone to these programmers have to some extent, at least they feel, been stonewalled.

Maybe that is not the case, and I am not prepared to say that categorically. But one of the provisions of this bill certainly will keep them from doing that.

Now, Mr. Chairman, you made the point in your opening statement about the cable companies. I have no quarrel with the cable companies as long as they conduct themselves properly, and as

long as the people in Arkansas and the rest of the rural areas of the country can get these programs at a fair, decent price.

But I believe, as you said, there is tremendous pressure on the programmers, and there is an integrated link between the programmers and the cable companies that causes me considerable stress, and that is one of the reasons we are asking the Federal Trade Commission to investigate this.

And they and the Justice Department have been dragging their heels on this.

But the point I want to make is, one of your erstwhile opponents, Rev. Pat Robertson, said that he did not want to encrypt his program, for fairly obvious reasons. But he said he had no choice because the cable companies were threatening him that they were going to cut off his program if he did not encrypt, which means they are looking to monopolize in their present franchised areas.

So what we are saying is, you have got to make this program available to any other distributor if you are going to make it to anybody, and you cannot limit the distribution, nor can you discriminate.

Thirdly, we say in this bill, the FTC should immediately begin an investigation on industry behavior. And while I think that would go a long way towards solving the problem, I would like to get this bill passed in a hurry so we can get that started.

And finally, Mr. Chairman, we say that we have 200,000 households in this country who cannot, because of the remoteness of where they live, receive a signal from the local outlets.

Later on there will be a dynamic woman from Arkansas testify who lives in St. Joe. She has been one of my most faithful correspondents. I hear from her more often than I hear from the poor folks. And she is very articulate on the subject about, what we are going to do. The networks are scrambling.

What are we going to do now about the 200,000 households who cannot get a signal from Little Rock or Nashville or Portland or someplace else, because they live in the valley between mountains, and who bought dishes, not so much to get HBO but to get normal network television? Now those people cannot get it.

And the idea is perfectly understandable. The networks do not want people taking satellite feeds that do not come from local affiliates, who depend on advertising revenues for their very existence.

But the fourth part of this bill says to the FCC: Institute a rulemaking procedure so that to the maximum extent possible you will provide programming to these 200,000 households in what are called white areas.

Finally, Mr. Chairman, to conclude, if you were to go down the list of all the stations in this country, the so-called programmers, there are 70 of them, and 32 of them are scrambling. 32 of the 70 programmers in this country are now scrambling.

And if you went down the list and looked at the charges you would have to pay if you called each one of them and said, I want your program—HBO, Cinemax, ESPN, right down the list—it would cost you somewhere between two and three times what it would cost you if you subscribed to a cable company that provided the same thing. It does not cost nearly as much to hook up a decod-

er as it does for the cable company to come out to your house and actually put wiring inside your house.

So Mr. Chairman, you can see that a good part of America, rural America, is being severely discriminated against.

I have no quarrel with General Instruments. Last year, MaaCom manufactured decoders.

Senator GORE. MaaCom was purchased by General Instruments.

Senator BUMPERS. So now you have a different company you are dealing with, and I want them to make money. I do not know whether they paid too much or too little for MaaCom, and that is beside the point. They have a right to use their technology and they have a right to make a profit.

But you have to balance that, as we often do in the free market system, with the rights of other people.

And you can talk about competition in the industry, and there is competition in the industry. But I can tell you one thing: Every one of those franchises are worth a small fortune, courtesy of the United States government. So we have a right to intrude where 1,300,000 households, soon to be four or five million households, in rural areas are being discriminated against and do not have these programs available to them.

Mr. Chairman, I thank you very much. I would be happy to answer any questions you or any other members of the panel may have.

Senator GORE. Thank you very much, Senator Bumpers.

Before going to questions for you, I would like to recognize Senator Pressler for an opening statement.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. Mr. Chairman, I thank you very much for holding these hearings today. I shall attempt to keep my opening remarks very brief, but I would like to make a few points to make my position clear at the onset.

One year ago today, we held similar hearings in this committee. We were told that the problem was being taken care of by the marketplace, and we were asked to leave it alone.

We were told that the descrambler shortage would be worked out by increased production, that the price of descramblers would fall because of technology advances and other market developments; that the price of programming would come down as more packages became available; that programmers were willing to talk to third party distributors in an effort to inject some real competition into the industry; and that dish owners would have access to fairly priced and competitive programming packages.

Mr. Chairman, we were told all of these things in this room a year ago, and I remember that hearing very well. And so we decided to let the free marketplace take its course.

Now, a year later, we are in a much worse position in my judgment. Like many of my colleagues at the time, I was skeptical of those assurances and ultimately voted in favor of legislation to force some change. On a very close vote, that legislation failed last year.

The argument that we should let things alone seemingly carried the day. But after a year of letting things alone, the problem appears to have worsened in my judgment. At least in my state it has.

Dish owners cannot get affordable programming or equipment. The price of descramblers has increased because of a continuing shortage. Dealers must pay more for descramblers than ever before. And small cable operators continue to be forced into paying twice the price for programming as the big MSO's.

And that is just outrageous, and that was a question I raised a year ago here with some of them, and we were told that this problem was going to be solved, in the marketplace I guess.

In short, Mr. Chairman, what I am saying is that the system is a mess and, despite free enterprise rhetoric to the contrary, the marketplace is not being allowed to work. It is not free enterprise.

Although I have reservations about some of the provisions of S. 889, I would support it if it were brought to a vote under today's circumstances. What we are faced with is a no compromise position on the other side. This is extremely unfortunate and I think shortsighted; I say that as one who supported the 1984 Cable Deregulation Act.

Let me say to the distinguished author of S. 889, Senator Gore, that I look forward to working with him on this legislation, and in fact I may become a co-sponsor. If it came to a vote today, I would vote for it.

But I would like to talk with you, Senator Gore, later about some areas in which I am particularly interested—to add some language possibly, including third party distribution of programming, second, the public television issue, and third, attempting to resolve the decoder distribution problem.

Perhaps we cannot deal with all these in a bill, but I think we should bring to the floor of the Senate some legislation, and I hope we include those subjects. It would be major legislation. But we cannot sit around and wait another year.

With that, Mr. Chairman, I will close my opening statement. I look forward to hearing everyone's views on this. I look forward to meeting with you to see if we can add some language that I would like to see in your bill. Generally speaking, I would vote for your bill today. I think it is a good one.

There are three areas that, in terms of my state, we would have to address. Maybe we will have to do it in other legislation. I would like to do it in yours.

Senator GORE. Thank you very much. And let me re-emphasize that this is a cooperative venture between myself and Senator Bumpers and Senator Ford, and we have met with a number of Senators who are interested in fine tuning it and joining as co-sponsors.

And I am sure I can speak for my colleagues in saying we would be delighted to sit down with you and look at the concerns that you might have.

We are going to hear from some interesting——

Senator BUMPERS. Mr. Chairman.

Senator GORE. Yes.

Senator BUMPERS. If I may, as is so often the case, you sit down after making a speech and realize you forgot your most important point. I did overlook one thing that is really essential in this, and that is a rulemaking by the Federal Communications Commission that will set standards for encryption.

One of the most important part of the bill is to make sure that the people who ultimately get decoders do not have to buy a variety of decoders because the encryptions are different and it takes a different decoder to decode each station.

We want a standard. It may be General Instruments' decoder or it may not be, but it is absolutely imperative that we have one standard decoder, so that you only have one sitting on top of your television set.

Senator GORE. Well, thank you very much.

And let me say, you made reference to the former chairman of the Communications Subcommittee, our esteemed former colleague and friend, Senator Goldwater, and the fact that he was opposed to this legislation when it came up last time. And he is so widely respected, that accounted for the fact that a lot of people who were sort of friendly toward the legislation were nervous about voting for it and did not vote for it.

I got a nice letter from Senator Goldwater just about a month ago, saying that upon returning home he had looked carefully at the problems that were facing dish owners and that he was reconsidering his view on this legislation; and that in his view the legislation might be right on target, to use his words.

And I am sure we will be hearing more about that. But I was most pleased to get that communication from him.

You mentioned the cost of the service to a satellite dish owner being less for the distributor or for the programmer than the cost incurred by a cable operator providing the same service. That is very true, and when you elaborate on that point you can see that in the case of a cable company, the capital expense of the distribution network is borne by the programmer and the distributor.

The customer has no outlay other than the cost of the television set. The capital expense is incurred by the person providing the service.

In the case of satellite distribution, that is reversed. The capital expense is borne by the customer. The customer purchases the satellite dish, in addition to the basic television set, and then the customer purchases the decoder.

In both cases, the cable customer and the satellite dish customer will be paying a monthly charge for the program. But in the case of the satellite dish owner, the costs of distribution are far less than in the case of the cable customer.

Why, therefore, should the costs—should the price to the customer be so much higher when that customer is a satellite dish owner, a person who has made the capital investment himself or herself? If the marketplace worked efficiently, one would expect the cost to be lower for a home satellite dish viewer.

If the owners of movie theaters controlled the video tapes that people rent to watch in their homes, what would the price be to rent a video tape to watch it one night?

Senator BUMPERS. First of all, Mr. Chairman, they would not be available at any price.

Senator GORE. They well might not be. But if there was political pressure and they felt like they had to at least make them available, one could imagine in those circumstances movie station owners getting together and saying: Well, we ought to make certain that the cost of renting the videotape is in no case lower than the ticket price to get in our movie theater, so as not to discourage people from coming to the movie theater.

Instead, there is not that control and the market dynamics are different. In the case of renting the videotape, the customer has to purchase the machine on which he or she views the videotape. They have to drive to the store and pick it up and bring it home, and then make another round trip to take it back, and the expense is borne by the customer.

For that reason and other reasons, the marketplace has driven the cost of renting a videotape down to a small fraction of the cost of buying a ticket to go into the movie theater.

Now, in the case of satellite dish customers versus cable customers, those marketplace forces have not been allowed to operate. Supply and demand—the supply and demand lines would cross, I am confident, at a price below the price for a cable-delivered program.

But the market has not been allowed to operate because, as I will demonstrate later with charts and as is well known to many people here, the programmers who distribute by satellite, the major ones are largely owned by cable television companies, and all of the others get their major source of revenue from cable companies.

Now, you mentioned the example of Pat Robertson and the Christian Broadcasting Network and the 700 Club. Indeed, that is right on target. They were told that if they did not scramble, then they would lose access to the large multi-system operators.

I will say this, that, as the chart will indicate, the Christian Broadcasting Network is one of only two that has agreed to contract with non-cable owned distributors, and will give them credit for that.

In any event, there are many other points that will be made during the hearing. Let me—my time is up at this point and I would like to recognize my colleagues in their order of arrival, and Senator Packwood is first.

Senator PACKWOOD. No questions, Mr. Chairman.

Senator GORE. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman. And thank you, Senator Bumpers, for your usual extremely articulate and forceful presentation.

On the issue of setting a descrambler standard, if the FCC does a rulemaking to establish a standard and it does not decide on it being the Videocipher, would that not cause confusion?

You see my point. Right now, the Videocipher seems to be, except for X-rated or certain specialized areas, to be the standard of the industry. And if the FCC then ends up deciding on another one, would that not cause a lot of confusion, although I do not see a rationale for them doing so.

Senator BUMPERS. Well, I am not at all sure that they would do that. However, I would like to make this point. It would create confusion and it would be discriminatory against people who have already bought a Videocipher II decoder. But bear in mind, you know, if we had done this last year this certainly would not be a problem, and that is the reasons why every day we procrastinate causes additional problems.

There are two million dishes in the country, and yet only 200,000 decoders have been sold. So only ten percent of the dish owners in this country have decoders.

But I have said I have no quarrel with this technology. As far as I am concerned now, FCC can pick Videocipher II as the technology.

And I think there may also be a possibility that I think the FCC would probably go along with it, and I am not a technician in this, so I am not at all sure that they might not change it somewhat so that the existing decoders would be good, but that a technology which would be compatible with it, but at variance with it, would allow other people to also manufacture to that standard.

Senator MCCAIN. So in your view——

Senator BUMPERS. That is one of the reasons we have asked for this rulemaking, Senator McCain.

Senator MCCAIN. And so in your view, then, this would not, as some have argued, be a freezing of technology in place?

Senator BUMPERS. It would not.

Senator MCCAIN. And it would naturally then—one would have to assume, since the FCC operates in the best interests of the consumer, that any other technology that they would agree to would be compatible with the present Videocipher.

Senator BUMPERS. I think it would, but I also think that one of the reasons we are here today is because I still believe that $400 for that decoder is an outrageous charge.

Senator MCCAIN. I am in absolute agreement with you, Senator, and I think that point has been very well made. And I know that you and I look for hearing the rationale as provided by the manufacturers, among others, and the programmers, as to why this price should be, at least in my knowledge of the income level of a lot of rural residents, prohibitively high.

Thank you, Mr. Chairman.

Senator GORE. Senator Danforth.

Senator DANFORTH. No questions, Mr. Chairman.

Senator GORE. Senator Bumpers, thank you very much.

Senator PRESSLER. Senator Gore.

Senator GORE. Oh, I am sorry, Senator Pressler. I acknowledged you for an opening statement, but not for questions. Please proceed.

Senator BUMPERS. He has been a presidential candidate. He deserves better than that.

Senator PRESSLER. You make a mistake once and hopefully you never do it again.

Let me ask you about the small cable companies in your state. Now, in my state it is not necessarily the dish owners versus cable, but sometimes it is the small cable companies also who have severe problems in this business.

Is that true in your state?

Senator BUMPERS. It is indeed. The small town cable companies are not nearly as prosperous now as they once were.

And I might also point out, Senator Pressler, that I have no quarrel with local cable companies cutting a deal with a programmer. All I am saying is that programmer should also be willing to cut that same deal with anybody else in the area.

We are trying to get competition, because if you really believe in the free market forces you believe that competition will take care of the price which, will take care of the consumer. But I am absolutely certain that there are some behavioral patterns here that are anti-competitive right now.

Senator PRESSLER. Well, anyway, I find in my state that they just will not deal with some of the small people, some of the small operators. I mean, they just do not negotiate and they have a hard time getting the same price and programming and all sorts of things.

Senator BUMPERS. Senator Pressler, General Instruments paid a courtesy call on me this week, and they will testify later and they have a very good argument. I understand this as a business proposition to them.

They will not sell decoders to anybody who is not willing to make an initial order of 300, and that runs in the vicinity of $100,000. And I can tell you, there are precious few cable companies in my state, to say nothing of these little retail dish owners, who can come up with $100,000 just to get into the decoder business.

And you can understand, General Instruments is doing what all business manufacturers in this country do. They take care of the big boys first.

And while I can appreciate somebody offering them a $10 or $15 million order and filling that order before they have filled one for ten from some small operator in Arkansas, by the same token there is something inherently unfair about that, because I think that alone has helped to maintain these anti-competitive forces.

Senator GORE. I would like to confirm for the record that small cable operators in Tennessee have also experienced some of the same anti-competitive problems, and I know of a number of cases where they have tried very hard to be fair to those in their general vicinity who do not—are not within the reach of cable and have tried to join the competition and served them with dishes as well, and have run into problems in that case, too.

But in their contracts with the programmers, they also face the power and the anti-competitive problems that we have described elsewhere in the hearing today.

In any event, thank you very much.

Senator BUMPERS. Thank you, Senator Gore.

Senator GORE. It is always a pleasure to work with you. We appreciate it.

And our first panel will now come to the witness table. We have a large panel and I would like to invite them at this time: Mr. Peter Pitsch, who is Chief of Staff, Office of Plans and Policy at the FCC; Mr. James P. Mooney, president and chief executive officer of the National Cable Television Association; Mr. Bert Carp, who is vice president of government affairs at Turner Broadcasting; Mr. Frederick Finn with Brown and Finn; Mr. Bob Thomson, vice presi-

dent of TCI; Mr. B.R. Phillips III, cheif executive officer with the NRTC, which is the National Rural Electric Coop venture in this area; Mr. David Wolford, chief executive officer of Home Satellite Services; and Mr. Chet Grochoski, who is vice president for policy administration and Corporate Development with Amway Corporation.

I believe you are all now seated at the witness table. I would like to tell all of our witnesses on this panel that your prepared statements will be included in the record in full.

We would like to request that you summarize your statement in your oral presentation and, because we have so many witnesses on this panel, we are going to enforce the time limit. We are going to give each of you five minutes. Please be comforted by the knowledge that your full statement will be available to the committee.

Excuse me, three minutes, three minutes. And we have the light system. Is it operating today?

So we will start with Mr. Peter Pitsch, Office of Plans and Policy with the FCC. Mr. Pitsch, welcome. Please proceed.

STATEMENT OF PETER PITSCH, CHIEF OF STAFF, OFFICE OF PLANS AND POLICY, FEDERAL COMMUNICATIONS COMMISSION

Mr. PITSCH. Thank you, Senator Gore. Mr. Chairman, members of the subcommittee.

I welcome this opportunity to present the Commission's views on the scrambling of satellite television signals. We have analyzed and continue to monitor the home dish market carefully. While the industry has experienced some trying times in recent months, there has also been important progress.

Our report's conclusion, that no government intervention in the home dish market is warranted, remains sound. Signal scrambling protects satellite cable programmers from commercial theft of their services and allows them to recover compensation from all who view their copyrighted product. It maintains the incentives to produce and distribute programming.

It is fundamentally a pro-consumer development that is likely to bring viewers new, popular, and diverse programming.

There are now 38 services that have scrambled or intend to do so using the Videocipher II or VC II system, up from 34 in February. No American satellite cable programmer has shown interest in another technology. This supports the report's conclusion that the VC II system has become the de facto industry standard.

Several program packages have developed and more are likely to be created as additional basic services scramble their signals. The Showtime package, which is available nationwide, consists of twelve basic and two pay services. Its prices of $20 per month for an annual subscription is comparable to or below cable subscriber rates.

One third party packager has firm plans to begin selling a package soon. A particularly noteworthy recent development is the Netlink-NBC agreement to provide the signal of NBC's Denver affiliate to households without access to NBC's service.

Netlink is discussing similar arrangements with ABC and CBS. Promotional packages are also being offered by some manufacturers and equipment distributors.

The temporary shortage of decoders is a matter of some concern. The shortage has apparently caused delays of one to six months in the scrambling schedules of a half a dozen services.

General Instrument Corporation [GIC] has made a sizable investment in expansion of productive capacity, which will be in place by September 1987. This measure appears likely to alleviate the shortage. I do not believe that government intervention can help speed up this adjustment process.

I am prepared to answer questions on the pirate chip problem. I better skip on.

On balance, I believe the dish market has moved forward since February. Some additional services have scrambled their signals using the VC II system and some additional program packages have been announced. It appears that programming will be available to dish owners from various sources at prices comparable to or below those paid by cable subscribers.

Moreover, GIC is acting to relieve the decoder shortage. While the Commission will continue carefully to monitor developments in the dish marketplace, the case against government intervention remains persuasive.

I will be happy to answer any questions that you have.

[The statement and questions follows:]

STATEMENT OF PETER K. PITSCH, CHIEF OF STAFF, FEDERAL COMMUNICATIONS COMMISSION

Mr. Chairman, members of the Subcommittee, I welcome this opportunity to present the Commission's views on satellite television signal scrambling. As you probably know, Chairman Dennis Patrick testified on this subject before the House Telecommunications Subcommittee on July 1, 1987. My statement today is a revised version of that testimony.

One year ago, at Congressional request, the Commission began an investigation of the terms and conditions under which satellite programming is being scrambled and offered to home satellite dish (HSD) owners. The investigation was undertaken in cooperation with the National Telecommunications and Information Administration (NTIA). Our findings were presented in a Report adopted by the Commission on February 12, 1987 and endorsed by NTIA.

The Report finds that the HSD market appears to be developing in an effective competitive way. It concludes that there is no current need for government intervention in that market, but that it is appropriate for the Commission to monitor the industry for one year. The Report explains the public interest justification for scrambling and notes that the market seems to have settled on the Videocipher II (VC II) system as the de facto scrambling standard. The Report also indicates that programming is available to HSDs from various sources, including programmers selling directly, cable operators, and other sources. The available information suggests that HSD prices will be comparable to or below those paid by cable subscribers. The Report finds that the major commercial networks are legally entitled to scramble the satellite feeds they use to transmit programming to affiliates. It also discusses "superstation" scrambling.

Because the industry is at an early stage of developement, and because we take seriously concerns expressed about the availability of descrambling equipment, program prices and distribution, and other issues, the Commission's staff was directed to monitor the industry for a year, providing quarterly reports to the Commission and NTIA during that period. The Commission indicated that if this continuing review disclosed the need for any corrective actions, it would undertake them promptly. At the end of a year, in early 1988, the Commission will deliver a final report to Congress.

We received the first progress report from the staff in late May and my remarks today are based in part on its findings. The report has been provided to members of the Subcommittee. Nothing that has happened since February alters the conclusion that no government intervention in the HSD maket is warranted. Additional services are scrambled with the VC II, additional program packages are becoming available, and prices are comparable to or below cable subscriber rates. It is true that the industry has experienced some trying times. It currently finds itself in the midst of a temporary shortage of Videocipher II decoders. Nevertheless, the various participants in the industry are working to alleviate the problems; for example, the production capacity for VC II decoders is being expanded in response to increased demand. The equilibration of supply and demand over time is precisely the type of function markets are well-suited to perform. And the shortage, while painful, suggests growing public acceptance of scrambling itself, and of the VC II as the standard system. Many in the industry undoubtedly wish that the supply of decoders could be expanded more rapidly, but I believe that legislative or regulatory intervention is simply not capable of achieving this result. The Commission shall, of course, continue carefully to monitor the HSD marketplace.

After briefly reviewing the public interest rationale for scrambling and surveying programmers' scrambling plans, I should like to summarize recent developments under three headings: program distribution and pricing; VC II issues, including decoder availability, piracy, and standard setting; and copyright issues. Signal scrambling has public interest justifications—it protects satellite cable programmers from commercial theft of their services and allows them to recover compensation from all who view their copyrighted product. This rationale applies to both premium and basic cable channels, since the former rely completely and the latter rely to a substantial extent on subscription fees to finance their program production and acquisition activities. The public interest is served when incentives to produce and distribute programming are maintained.

Scrambling is thus fundamentally a pro-consumer development, one that is ultimately likely to bring to viewers new, popular, and diverse programming. Indeed, in its comments in the scrambling inquiry, Home Box Office noted that, since beginning scrambling, it has been able to acquire exhibition rights to certain boxing matches previously denied to it.

At this point, 32 program channels are scrambled in some manner using the VC II technology. This includes channels scrambled full-time in the addressable mode, as well as those that are test-scrambling on a limited basis. Four more channels have firm plans to scramble using the VC II, and an additional two appear inclined to adopt the VC II mode. The decoder shortage has apparently caused delays of one to six months in the scrambling schedules of half a dozen services. To date, no American satellite cable programmer has indicated that it is considering another technology. Two services that do not serve cable systems—a late night "adult" service operating two nights per week, and a pay-per-view service operating four nights per week—do use other systems.

The February Report listed 34 services that had scrambled or intended to do so using the VC II. There are now 38 services in those categories. Thus, the Report's conclusion that the VC II has become the de facto industry scrambling standard has received additional confirmation. The report estimated that there were a total of 70 satellite-delivered services. A recent trade association compilation includes a substantially larger number of unscrambled services but contains some from Canada and some that transmit only a few hours per week.

PROGRAM DISTRIBUTION AND PRICING

While most of the scrambled services are available on a *a la carte* basis, several program packages have developed and more are likely to be created as additional basic services scramble their signals. Packages are now available from programmers and from cable operators; and one "third party" packager—that is, an entity that is neither a programmer nor a cable operator—has firm plans to begin selling a package soon. Promotional packages are also being offered by some manufacturers and equipment distributors.

The most comprehensive programmer package is offered by Showtime. It includes 12 basic services plus Showtime and The Movie Channel. It is available nationwide at a price of $20 per month for an annual subscription. Showtime recently announced a new promotional campaign that could drop the price of an initial one-year subscription to $16.25 per month. These rates are well below typical cable subscriber prices for basic service plus two premium channels. Showtime is actively seeking the rights to provide additional services to HSD households.

Home Box Office has also indicated its interest in providing a program package. Additionally, it has recently announced that it is investigating the possibility of providing a C band feed of its new "Festival" service to HSD households. Home Box Office's initial plans called for transmitting the service on the Ku band only and not offering it to HSDs. However, in his prepared statement for the House Telecommunications Subcommittee hearing, an executive of Home Box Office stated that "if there is a demand for 'Festival' among dish owners, HBO is anxious to satisfy that demand."

Another firm, Netlink, plans to offer network stations to HSD households. Recently, NBC and its Denver affiliate *agreed* to allow Netlink to deliver that affiliate's signal by satellite to HSDs without acccess to an NBC affiliate over the air or via cable. Netlink reportedly will charge HSDs $2.00 per month for the service. It will not be required to pay any fee to NBC or its Denver affiliate. Netlink is in the midst of negotiations with ABC for a similar arrangement and it has begun to talk to CBS as well. (CBS had earlier declined to participate in an arrangement of this nature.) Showtime, offeror of the most comprehensive package of cable programming to HSDs, is also exploring with the networks the possibility of providing network stations as part of its package.

Netlink's plan, which is contingent on reaching agreement with the other networks (and their relevant affiliates) is to offer HSDs one, two, or three network services for the $2.00 monthly fee. HSD households will be eligible to receive only those networks whose affiliates cannot be received off-air or via cable. Netlink hopes to provide the Denver PBS affiliate at no extra charge to all of its network subscribers. It also intends to negotiate with Fox Television, owner of a Denver independent station, for carriage rights. These developments represent a restructuring of Netlink's original plan to offer a six-channel package for $6.65 per month.

Packages are also available from various cable operators. The two most comprehensive are offered by United Cable and TCI. They are available in, and in some cases adjacent to, the franchise areas of these large multiple system operators. Obviously an important issue is the price of HSD packages relative to that of cable subscribership. These packages are priced comparably to or below cable subscriber rates. Both United and TCI lease decoders to subscribers with a three-year commitment.

The National Rural Telecommunications Cooperative (NRTC), a third party packager, has announced firm details of its plan, which includes a six-channel basic package. Four other services, including a pay-per-view movie service, will be available at additional fees. NRTC will wholesale its package to its member cooperatives, which will set their own retail prices. It plans to have the package available by late summer. Two other prospective third party packagers continue to work on assembling packages, but at this point they have not signed any contracts with programmers.

Several manufacturers have assembled promotional packages to be provided to purchasers of their integrated receiver decoders (IRDs). The IRD is a satellite television receiver with VC II decoding capability built in. General Instrument Corporation (GIC) is launching its "Panorama" program on July 1, 1987. Under this plan, those who purchase a GIC IRD by December 31, 1987 will receive a six-channel package free for one year. Purchasers of an IRD from Drake, another manufacturer, receive free three-month subscriptions to SelecTV (a movie channel) and the SBN package.

In early March, Turner Broadcasting and two manufacturers, Echosphere and Houston Tracker, announced that those who bought IRDs from either manufacturer by June 30, 1987 would receive a free one-year subscription to 28 services described as "scrambled or soon-to-be scrambled." Turner had also planned to market the program package separately but recently put those plans on hold.

Various equipment distributors have also assembled packages. They generally purchase bulk subscriptions to basic cable services at a discount and pass some of it along to their customers. Some also pass along part or all of the promotional rebates offered by programmers like Home Box Office and Showtime.

VIDEOCIPHER II ISSUES

The availability of VC II decoders and the use of "pirate" chips to descramble programming without paying for it are continuing to concern the industry. There are also some who continue to advocate that the FCC set technical standards for encryption. Let me address the last point first.

Encryption standards

I have already noted that over three dozen satellite cable services, including all of the most popular ones, are using or planning to use the VC II system. Thus, a de facto standard has already been chosen by the marketplace. Consumers need buy only one decoder. A government-mandated standard, in addition to being unnecessary, would also limit the incentives for improvements in the technology. Furthermore, programmers and equipment manufacturers are unlikely to alienate customers and distributors by capriciously changing technologies in such a way as to render existing equipment obsolete. Improvements are likely to be compatible with the original system and/or to occur gradually, so that any incompatible equipment may be amortized. This does not rule out, nor should it, the chance of a quantum leap in technology, leading to drastically improved quality and/or reduced cost.

The Videocipher II shortage

A letter in late April from the president of the Satellite Broadcasting and Communications Association (SBCA) to GIC has initiated a dialogue, including various meetings between GIC and others in the industry, on industry concerns with respect to the VC II. The single biggest concern was a shortage of VC II decoders. The shortage involves three separate products. Standalone consumer units have been most heavily affected, but the situation extends to the commercial units used by programmers' cable affiliates, and to the VC II modules that are used in integrated receiver decoders (IRDs).

GIC has made a sizeable investment in expansion of productive capacity, which will be in place by September 1987. That capacity will allow for production of as many as 100,000 VC II units per month. Current plans call for production in September, 1987 of 82,000 VC II units—standalone decoders and modules—by GIC and its second source licensee, Channel Master. By comparison, 30,000 were shipped in March, 33,000 in May, and 40,000 in June. GIC estimates July shipments at 50,000 units and indicates that its expansion is proceeding on schedule.

GIC has also announced an agreement in principle to allow Channel Master to sell modules on the open market. This agreement accelerates the schedule for direct sales contained in Channel Master's patent license. It will allow Channel Master to sell to the other dozen or so firms with licenses to build IRDs any modules produced beyond its commitment to provide GIC up to 12,000 modules per month. A representative of Channel Master appeared before the House Telecommunications Subcommittee on July 1, 1987. He stated that Channel Master will begin delivering "modest quantities" of modules to customers other than GIC in August. By the end of the year, Channel Master's current production capacity of 30,000 units per month will be available to customers other than GIC. Channel Master's actual production and sales will, of course, depend on demand. Should demand warrant it, Channel Master's capacity can be increased by 50 percent with a four-month lead time.

During the period in which supply capability is being expanded to meet demand, dealers will likely be unable to satisfy all potential customers, and manufacturers will probably be unable to fill all equipment orders placed with them. While a shortage is a vexing situation for market participants, a temporary shortage *per se* is *not* an indication that the market is "not working" or that goverment intervention is necessary or would be efficacious. A shortage is simply a situation in which the quantity demanded of an item is greater than the quantity supplied. Shortages can arise from abrupt increases in the demand for a product or from inaccurate forecasting of demand changes, among other things. In January of 1987, GIC apparently had substantial inventories of decoders and had placed advance orders for parts to build additional large quantities. By the end of April, a severe shortage had set in. The lead time on parts orders for the VC II, the time needed to set up new production facilities, and the time needed for transportation from factories in the Far East mean that several months must elapse between a decision to expand and the time the increased supply begins to become available.

GIC, the primary manufacturer of VC II decoders and modules, has, I believe, a clear interest in filling the excess demand and has, as I have indicated, moved to expand its production capacity to do so. I can think of no government action that could alleviate the shortage faster or more efficiently than the expansion of capacity prompted by increased market demand will do. Indeed, intervention might well prove counterproductive. It could confuse the expectations that market participants are now forming and acting upon. If, for example, a moratorium on scrambling were imposed, or the Commission were ordered to begin the long process of adopting a standard, manufacturers might well cut back significantly on VC II production and consumers might hold back on purchases in order to see the extent of scrambled programming offered in the future to HSD households. Rather than hastening the

development of a competitive market for scrambled programming, such intervention could do just the opposite.

While standalone decoders are now scarce, they are not completely unavailable. Anixter, a leading distributor, sells VC II units directly to consumers nationwide via a toll-free telephone number (800-672-6190). A call by a member of my staff on July 27 revealed that they have decoders in stock for sale at $409, including installation kit plus shipping and handling. Delivery was promised in about seven days. Anixter also markets Cable News Network and Headline News for $25 per year and Christian Broadcasting Network for $15 per year. There are, of course, other sources of decoders, including various programmers who sell them along with subscriptions to their programming services.

Programmers' commercial affiliates—cable systems, SMATV systems, hotels, and other entities—need commercial VC II units in order to decode scrambled transmissions. Programmers worried about temporarily interrupting service to some customers due to the shortage are free to delay the implementation of scrambling. The shortage of commercial units has, in fact, caused some programmers to do so. This suggests that legislatively-imposed delays in scrambling are unnecessary.

Our survey identified six cable services that indicated the shortage caused them to delay. The time periods involved were one to six months. As with the consumer unit shortage, it appears that the commercial shortage will be alleviated in the next two months or so. In the meantime, home satellite dish viewers enjoy additional months of free, unscrambled service from those channels that have delayed scrambling.

The shortage also affects modules for IRDs. However, most manufacturers of IRDs are just getting started and their demand for modules is not great. Nevertheless, the two firms that are already into fairly large scale production of IRDs complain vigorously that a large fraction of their advance orders are not being accepted. GIC has apparently not accepted all of these orders. In a letter to the SBCA president, GIC describes the volume of orders from these sources as "unrealistic." It claims that filling them all would "freeze out the rest of the industry" for a while.

I have noted that, during the shortage, some dealers and distributors have apparently raised the price of VC II decoders above GIC's suggested retail price of just under $400. As the shortage eases, the price of standalone decoders is likely to fall back toward that level. However, I believe that ultimately the major drop in the price of decoding capacity will come as consumers begin to buy IRDs. The VC II module for the IRD is available to manufacturers for $150. The incremental price of decoding capacity to buyers of IRDs is thus $150, plus the added tooling and related costs for manufacturers to insert the modules (which GIC estimates at $25 per unit), plus whatever markup is added by the manufacturers.

Some observers cite the decoder shortage as an explanation for the low level of home satellite dish equipment sales in recent months. HSD sales peaked in 1985 at 522,000 (which represents almost one-third of the 1.7 million home dishes now in use). In 1986, dish sales fell to 257,000, a drop of 50 percent. During the first half of 1987, 107,000 home satellite dishes were sold. If sales continue at this rate for the remainder of the year, the 1987 total will fall below that for 1986. However, if the decoder shortage is having a significant impact on dish sales, the alleviation of that shortage during the last four months or so of 1987 could cause 1987 dish sales to be higher, perhaps even equalling the 1986 level.

While dish sales have been very low over the past 18 months, it does not necessarily follow that the dish market is "not working." Sales may well have been effected by the fact that the necessity of paying for programming made dishes less attractive to some potential buyers. Uncertainty about decoding technologies and whether a standard would develop, about programmers' scrambling plans, and about the possibility of government regulation may also have caused some consumers to delay or cancel their plans to buy a dish. The marketplace is clearing up the uncertainty in the first two areas and doing it in a way that legislation is unlikely to improve upon.

Piracy

The issue of Videocipher II "piracy" is also an important one. We are aware of the existence of so-called "pirate" chips, electronic components which allow for reception of programming without payment for it. GIC is combatting the use of these chips with both legal and technical measures. GIC has obtained injunctions against certain distributors of these chips in Phoenix, Arizona, and recently filed a lawsuit in Miami, Florida against others suspected of involvement with the illicit chips.

The technical measures involve redesigning the VC II module to make it more tamper-proof, and taking certain "electronic countermeasures" to protect the integ-

rity of the VC II code. The design change involves a process known as "potting," in which key components of the VC II module are encased in epoxy. This makes it more difficult to remove a chip from the decoder and to replace it with a "pirate" one.

The electronic countermeasures entail deauthorization of decoders that GIC has reason to believe have been altered. About 12,000 decoders have been effected under these electronic countermeasures programs. These represent 6.3 percent of the 190,000 decoders that had been authorized as of June 30, 1987. A total of 337,000 decoders had been shipped by that date. Earlier, GIC officials had estimated that over 30,000 of the 264,000 decoders shipped as of April 30 were in the hands of "pirates."

Without examining individual decoders, it is impossible to tell with certainty if one has been altered. GIC claims to know of fewer than 50 "mistakes" in the process, *i.e.,* decoders without pirate chips and which programmers had authorized to receive unscrambled programming that had been turned off by GIC under its countermeasures program. In such cases, GIC replaced the module with one less susceptible to tampering and returned the decoder without charge. The owners of these decoders will receive a refund of the $20 fee they had paid to ship their decoders back to GIC, and will also receive one year of free programming in a promotional package that GIC is now developing. GIC apparently intends to handle other mistaken deauthorizations the same way.

It appears that GIC has the appropriate incentives to protect the security of the system. GIC is apparently trying to balance the need to protect the integrity of its encryption system against the possibility that some decoders without "pirate" chips attached may be deauthorized. Given its long-term business interest in making the system attractive for programmers to use and for consumers to buy, GIC is not likely to deauthorize decoders randomly or capriciously. Although it is impossible to predict the future extent of piracy, it is clear that activities of this type are continuing. Some even claim that a device that would allow reception of scrambled programming without resource to a VC II at all is under development.

Consumers whose decoders are inappropriately turned off may, if not satisfied with GIC's response, have cause for a civil action against GIC or against programmers with whom they have contracted for service. The authorization and deauthorization of VC II decoders are not covered by the rules and regulations of the Federal Communications Commission.

COPYRIGHT ISSUES

The question of whether copyright law permits provision of uplinked network stations and independent superstations to HSD households is a key unresolved issue, but one that is likely to be resolved outside of the FCC. While cable systems have a compulsory license to retransmit television broadcast signals, it is currently not clear whether that license is applicable to HSD households. Two satellite common carriers of "superstations" have concluded that the license is not applicable, and one has concluded that it is. (Late press reports indicate that one of the two—Tempo, the satellite provider of WTBS—has changed its position and now *will* offer WTBS to HSD households.) The compulsory license was set up by Congress and is being interpreted in the courts. I note that Congressman Kastenmeier recently introduced HR 2848, which would clarify the application of the license to HSD households. Also, the Copyright Office has an outstanding notice examining application of the compulsory license to MDS and SMATV. The Commission's Notice of Inquiry on the subject of the cable compulsory license does raise the issue of treatment of rival media. At most, though, this inquiry would result in legislative recommendations by the Commission.

We are aware that some households do not have access to network service over the air or via cable. The two primary suggestions that have been made for reaching them are delivery of local network station signals via satellite to HSD households, and provision by the networks of a "clean," addressable feed to unserved areas.

With reference to the first option, SBN currently sells a package of three network stations to HSD households throughout the country. ABC, CBS, and the Gannett Company, the owners of the three stations, have challenged the SBN service in the courts. NBC and others have also filed suit against SBN. In the Report, we indicated that if this service, which entails selling the signals of network stations without the permission of either the station or the network, is found by the courts to be in compliance with the Copyright Act, it would then be appropriate for us to address this matter from the point of view of general communications policy.

The plans of Netlink, whose package is not yet being sold to HSD households, were described above in the section on program distribution and pricing. Unlike SBN, Netlink plans to sell only in unserved areas (those without service over the air or via cable). Also, Netlink is seeking the consent of the networks and the relevant stations for its transmissions. Recently NBC and its Denver affiliate agreed to allow Netlink to deliver that affiliate's signal by satellite to HSDs that do not have access to an NBC affiliate over the air or via cable. Under the agreement, Netlink will not be required to pay any fee to NBC or its Denver affiliate. "Serious" negotiations are underway with ABC and "preliminary" deductions are being held with CBS. Netlink will reportedely charge HSDs $2.00 per month for up to three network services. While all HSD customers will pay the same fee, each one will receive only those network services not available off-air or via cable.

With reference to the second option, provision of "clean" feeds, our Report concluded that the satellite feeds used by the networks to deliver programming and other matter to their affiliates are in fact private communications, and that unauthorized interception of them would violate Section 705(a) of the Communications Act. The networks plan to scramble these feeds eventually, but they do not plan to offer them to HSD households. Because of the legal status and high costs, and because of uncertainty about the mechanics of implementing proposals for a "clean" feed to unserved areas, we declined to endorse this option.

CONCLUSIONS

On balance, the HSD market has moved forward since the February Report. Some additional services have scrambled their signals and some new program packages have been announced. Additional services will be scrambling in the next several months. The packaging announcements suggest that programming will be available to HSD households from various sources at prices comparable to or below those paid by cable subscribers.

The scrambling of additional services underlines the importance of an expansion of VC II production capacity. The current temporary shortage, particularly of standalone units, is frustrating for the industry and is certainly cause for concern. However, I believe that GIC has clear incentives to respond to the increase in demand, and it appears that GIC is in fact doing so. Furthermore, I believe that GIC's decision to share its production plans with some others in the industry will help in the adjustment process. I do not believe that government intervention at this time can help speed up the adjustment process by which the market is equilibrating supply and demand. Intervention could well prove counterproductive. It could confuse the expectations that market participants are forming and acting upon. We recognize, however, that the complexity and stage of development of this market dictate close scrutiny. Thus, the Commission will continue carefully to monitor developments in the HSD marketplace. To date, the case against direct government intervention remains persuasive.

I will be happy to answer any questions that you might have.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

Question 1: If you assume that the marketplace is not working, will the remedy contained in S. 889 requiring the use of third party distribution resolve the problem?

Answer 1: The third party distribution provisions of S. 889 are unlikely to improve the operation of the home satellite dish (HSD) programming market. The bill requires programmers either to be their own sole HSD distributors or to "establish reasonable financial and character criteria under which distributors may qualify to distribute" their programming, and not discriminate among those who meet the criteria. Passage of S. 889 could result in fewer rather than more program packages if programmers choose to become their own sole distributors. Nor is it clear how or whether a programmer could vary its distibution arrangement if costs of distribution varied among its distributors. If this justification were allowed, then difficult factual questions would need to be resolved to determine whether discrimination had occurred. If this justification were not permitted, S. 889 might well require discriminatory treatment of efficient distributors.

In any event, S. 889 appears to be unnecessary. The programming market is quite rivalrous. Such competition among programmers will spur them to pick efficient distribution systems. If the most efficient system requires fewer distributors than the bill's third party provisions would allow, then passage of the bill would disadvantage consumers by ruling out the most efficient distribution mode. It could lead to the demise of packages of services not commonly-owned.

Even if third party distributors were to enter the market, there is no evidence that they would bring consumers lower prices or better service than currently-established distributors could provide. Because few basic cable services have begun to scramble, there have not been many developments with respect to packaging. Nevertheless, Showtime recently announced a package of 12 basic and two pay services at $20 per month for a one-year subscription. Other programmers, such as Home Box Office, are planning to put together discounted program packages. The same is true of major cable operators. For example, United Cable offers a basic plus two pay services package for $24.95 per month; with a three year commitment, a Videocipher II decoder is provided for lease at $5.00 per month. These rates are comparable to or below cable subscription rates, and comparable to or below the pricing goals announced by the would-be third party packagers National Rural Telecommunications Cooperative and Home Satellite Services.

Thus, while third party distributors, should they develop, would provide an additional option for consumers, their absence is not a sign that the market is not developing competitively.

Question 2: Could you explain how dish owners will receive network programming in view of the fact that at least one network is going to use the Videocipher I system?

Answer 2: The three major commercial networks all plan to scramble their network feeds eventually, but they do not plan to offer them to home satellite dish (HSD) households. CBS has announced its intention to use the Viodeocipher I system. The network feeds are satellite transmissions that the networks use to deliver programming to their affiliates for immediate or delayed broadcast. The transmissions also include various material that is not intended for broadcast at all. For a detailed description, see para. 154-158 of the attached Report in General Docket No. 86-336. Our Report concluded that these satellite transmissions are in fact private communications, and that unauthorized reception of them would violate Section 705(a) of the Communications Act.

The two primary suggestions that have been made for reaching households without access to network service over the air or via cable are provision by the networks of a "clean," addressable feed to unserved areas and delivery of local network station signals via satellite to HSD households. The Commission declined to endorse the first option. This decision was based on the high costs and uncertainty about the mechanics of implementing proposals for a "clean" feed, as well as the legal status of these feeds. Thus, the choice of a scrambling system other than the Videocipher II for the network feed will not affect the availability of network programming to dish owners.

The second option, satellite delivery of local network stations to HSD households, appears more promising. A firm called Netlink recently concluded an agreement with NBC and its Denver affiliate to allow Netlink to deliver the affiliate's signal by satellite to HSDs that do not have access to an NBC affiliate over the air or via cable. Under the agreement, Netlink will not be required to pay any fee to NBC or its Denver affiliate. "Serious" negotiations are underway with ABC and "preliminary" discussions are being held with CBS. Netlink will reportedly charge HSDs $2.00 per month for up to three network services. While all HSD customers will pay the same fee, each one will receive only those network services not available off-air or via cable. Although the Netlink package is not yet being sold to HSD households, it appears to be a promising source of network programming for dish owners.

Satellite Broadcast Networks (SBN) currently sells a package of three network stations to HSD households throughout the country. ABC, CBS, and the Gannett Company, the owners of the three stations, have challenged the SBN service in the courts. NBC and others have also filed suit against SBN.

Question 3: If Videocipher II is the de facto standard, would you object to the adoption of a law which says that all scrambling must be done in conformance with Videocipher II?

Answer 3: In view of the status of the Videocipher II system as the de facto standard, mandating that standard appears to be unnecessary. Moreover, a government-mandated standard could be harmful because it would also limit the incentives for improvements in the technology. Programmers and equipment manufacturers are unlikely to alienate customers and distributors by capriciously changing technologies in such a way as to obsolete existing equipment. Incremental improvements are likely to be compatible with the original system and/or gradual, so that any incompatible equipment may be amortized. Nonetheless, such incremental changes could improve quality and facilitate competition by rival manufacturers. Moreover, technical standards, by raising the costs of introducing new technology, could reduce the chances of a quantum leap in technology, which could lead to drastically improved quality or reduced cost.

Senator GORE. We are going to withhold questioning until all panelists have completed their presentations.

Thank you very much, Mr. Pitsch.

Our second witness is Mr. James P. Mooney, who is president and CEO with the National Cable Television Association here in Washington, D.C. Welcome, Mr. Mooney.

STATEMENT OF JAMES P. MOONEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL CABLE TELEVISION ASSOCIATION

Mr. MOONEY. Thank you, Mr. Chairman. I would like to use my time to make two points which I think go to the heart of this controversy.

My first point is that all of the cable satellite programming which has been scrambled thus far is in fact being made available to the home dish owner at a reasonable price. No dish owner is being denied access.

As to prices, as you can see from the chart we have put up over here, Showtime, for example, is using an 800 number to market directly to dish owners a package which includes both Showtime and twelve basic services for $17.95 per month. If the dish subscriber takes an annual subscription, the price is reduced to $16 a month.

The average cable subscriber is paying a little over $23 a month for the same package. So as you can see, the dish owner is getting a substantial discount. In fact, he can get a discount of 30 percent.

HBO, which is Showtime's principal competitor in the pay television world, similarly sells its service to home dish owners at an annual rate which is less than that charged to the average cable subscriber, and we expect HBO in the very near future also to announce a package of basic services which will compete with Showtime's in the home dish market.

So what you have got here, therefore, is a competitive market that is developing around first party distributors, which is to say the programmers themselves.

And my second point is that, while we are conscious of and respectful of the concern of many members of this committee with respect to third party distributors, we know of no economic principal that says the market can be said to have failed per se unless third party distributors are present.

We think competition can exist as well with first party distributors, again in this instance the programmers. So to summarize, Mr. Chairman, we think that it is a fact that people are getting these services. They are getting them for substantially less than cable subscribers are paying, and over 200,000 home dish owners have already subscribed to scrambled cable programming.

We understand from General Instruments that new authorizations are running at a rate of about a thousand a day, and we therefore believe the market is working and we respectfully hope you will let it develop by itself.

Mr. Chairman, I will stop there. I will be happy to answer any questions you may have.

[The statement and questions follow:]

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STATEMENT OF JAMES P. MOONEY, PRESIDENT, NATIONAL CABLE TELEVISION ASSOCIATION

Mr. Chairman, members of the subcommittee, my name is James P. Mooney. I am President and Chief Executive Officer of the National Cable Television Association, the principal trade association of the cable television industry. NCTA represents over 2,400 cable television systems, serving more than 80% of the cable households in the United States, and 71 cable programming services, whose signals are distributed by satellite to cable systems for retransmission to our subscribers' homes.

The subcommittee has before it today S. 889, a bill to regulate marketing practices for satellite-delivered television programming. NCTA believes that they key objectives of this bill already are being achieved today in the marketplace. A competitive marketplace is developing. Home satellite dish (HSD) owners are able to obtain much programming for free and where payment is required, to pay less than the average cable subscriber. The HSD business has stabilized and is growing again. Legislation is more likely to hurt consumers by retarding improvements in the pay television marketplace generally, and the HSD marketplace specifically, than it is to help them. Therefore, we urge the committee not to take legislative action.

Home satellite dish owners today are able to obtain all of the cable services for less than the price paid by average cable subscribers. For example, if a dish owner purchases Showtime or The Movie Channel for $10.95 per month, Viacom will discount its basic service package to $7.00 per month; so the dish owner could receive Cable News Network, Headline News, ESPN, Christian Broadcast Network, MTV, VH-1, Discovery Channel, Nickelodeon, Learning Channel, Lifetime, the USA Network, and a premium movie service—all for $17.95 per month. The cost to the average cable subscriber for a comparable package of cable services is $23.13. S. 889 would only add needless cost for dish owners, depriving them of the relative bargain they enjoy today.

At this committee's hearings on scrambling last year, we discussed the cable television program marketplace, the development of scrambling, and consumer purchasing opportunities. For the benefit of new members of the committee, we would like to review and expand on the comments we made last year, then turn to the process that has been made since that time in serving the backyard dish market.

CABLE TELEVISION PROGRAMMING

The programming created for and provided by cable television as an alternative to broadcast television is so popular today that it is almost taken for granted. Yet only ten years ago, most of these services were nonexistent. Their development was made possible by two key factors.

The first factor was the discovery of what has proved to be a huge public appetite for programming other than that which customarily appears on broadcast network television and reruns. Cable satisfies that appetite, and indeed, cable already has had a positive competitive effect on broadcast programming as well. We note that more and more broadcasters are trying to emulate cable's successful formats, from new UHF stations which seek to copy MTV, to public broadcast stations that have reduced their reliance on BBC programming in favor of American-made programs originally made for cable. We note the coverage of the Iran-contra hearings has been televised by the network and PBS in the format pioneered by the cable industry's public affairs network C-SPAN, a style of journalism that makes the view a direct witness of events, without a newsperson interposed as an interpreter.

The second key factor in the development of cable programming services is the result of the dramatic change satellite technology has worked in the economics of distribution. Satellite delivery, which began in 1975, allows programmers to reach most cable operators with a single transmission—it simply is a more economical and efficient means of wholesale distribution than the terrestrial landlines and microwave relays that were used before. Just as telephony, news wires, and broadcast networks have moved to satellites to satisfy their internal distribution needs, so has the cable industry.

There are today approximately 80 satellite cable services being delivered nationwide, and about 12 regional cable services which also are transmitted to cable headends by satellite. Of these services, the so-called "premium services"—those which are availabe to cable subscribers generally as a separate, single purchase option—derive virtually all of their revenue from subscriber fees. However, even the "basic services" are heavily dependent on cable subscriber fees, though many of them accept advertising as well.

In 1986, for example, the 24-hour sports channel ESPN derived 42% of its revenues from cable subscriber fees. For Cable News Network, Arts and Entertainment,

and the children's channel, Nickelodeon, the proportion of revenues derived from cable subscribers was 47%, 62%, and 59%, respectively. This dual revenue stream from advertising and subscription fees is typical of all but a few of the satellite cable services.

It is this important distinction that allows cable television to develop and provide quality programming that is substantially different from that offered by broadcast television. Broadcasters derive revenue solely through advertising, and, as a result, are driven inexorably toward lowest common denominator programming in order to attract as broad an audience as possible. Because cable television is pay television, however, there is less pressure toward the lowest common denominator, and more flexibility to provide quality, targeted programming. Indeed, it is only because subscribers are willing to pay a monthly fee for services like Arts and Entertainment, Nickelodeon, and Cable News Network that these services are able to exist at all.

THE REASONS FOR SCRAMBLING

Before 1979, ordinary consumers were prohibited by FCC regulation from owning home satellite dishes, or "TVROs" (for television receive-only antennae). Late in that year the FCC, without objection from our industry, deregulated HSD ownership. For the next six years, the ability of HSDs to receive cable television program services for free certainly contributed to the emergence of HSDs as an increasingly important part of the television landscape.

Yearly HSD totals 1981–87

1981	21,000
1982	71,000
1983	296,000
1984	796,000
1985	1,496,000
1986	1,721,000
1987 (estimate)	2,046,000

Source: Paul Kagan Associates.

As HSD ownership passed the million mark, scrambling became a necessary part of distributing pay television by satellite. As Congress recognized in enacting Section 705 of the Cable Communications Policy Act of 1984, over the long run it is neither fair nor commercially substainable for HSD owners (and others, such as non-paying commercial establishments) to receive for free the key program services for which cable subscribers must pay. A marketplace response was inevitable and necessary. The Cable Act expressly contemplated that scrambling would be the marketplace solution that would emerge to meet the needs of home satellite dish owners while protecting those with proprietary rights in the transmitted programming. And, in fact, that is occurring. The advent of a sophisticated and workable scrambling technology has given cable programmers the incentive to provide mechanisms for making scrambled programming available to the satellite home viewer at competitive prices.

THE TECHNOLOGY OF SCRAMBLING

The history of the development of scrambling technology demonstrates that from the beginning the cable networks had a strong interest in and commitment to serving the HSD market. Home Box Office took the initial step in this regard, by insisting on development of HSD-compatible technology for scrambling of its service. By also adopting this single HSD-compatible technology, the other scrambled cable programmers have assured a marketplace that is not only accessible to the HSD owner, but which keeps the need for equipment purchases to a minimum.

The technology used to scramble and descramble satellite-delivered cable progamming is the Video Cipher II. The system was developed by M/A-Com Cable Home Communications (now a division of the General Instrument Corporation) under contract to Home Box Office. Originally HBO pursued development of a scrambling technology designed to thwart commercial theft of its product. M/A-Com in response developed the Video Cipher I, an extremely secure—and expensive—encryption system. A single decoder for Video Cipher I costs about $3,500. Video Cipher I remains an excellent technology except for its economic incompatibility with HSDs. For example, CBS will use the Video Cipher I to protect its backhaul transmissions and affiliate feeds, signals it does not intend to make available to home dish owners.

However, Home Box Office asked M/A-Com to refine the Video Cipher I into a technology that would permit HBO to market its signals to backyard dishes. HBO

had three main criteria for this consumer-oriented technology. First, it had to be affordable. Second, it had to be able to handle a broad range of signals. Third, it had to be as technologically compatible as possible with the existing population of dishes.

M/A-Com responded with the Video Cipher II. Although the system is in some ways less secure, instead of costing $3,500, a stand-alone module would carry a suggested retail price of $395. People who already owned dishes are the purchasers of these units. Buyers of new dishes can get the descrambling elements built right into their systems. That eliminates some of the duplicative receiving equipment necessarily included in the stand-alone and lowers the cost of descrambling.

To promote the growth of the HSD marketplace, M/A-Com established its multimillion dollar encryption and authorization facility in San Diego, California, as a "free trade zone" so that any programmer, not just cable programmers, using Video Cipher II technology could be included in the same satellite data stream and therefore be receivable by any dish owner with a Video Cipher II unit.

In their report on the *Inquiry into the Scrambling of Satellite Television Signals and Access to Those Signals by Owners of Home Satellite Dish Antennas,* the FCC and NTIA estimated that the Video Cipher II modules are automatically compatible with 87.5% of existing HSDs, and that with minor modifications all but 2.5% of existing HSDs can be made compatible.

Even after HBO made its choice, other cable networks could have used other available technologies that were either incompatible with sale to HSDs or that would require purchase of multiple decoders, because uniform technology is of no particular advantage to cable television operators. Home dish owners can switch from channel to channel with a single descrambler so long as there is a single technology, but operators must install a separate descrambler for each channel offered to their customers. Without strong desire on the part of the cable programmers to serve the HSD market, the selection of technology would almost certainly have evolved in a very different manner.

Today, every cable programmer that has scrambled has used the Video Cipher II technology. Every cable programmer that has announced an intent to scramble has also announced an intent to use the Video Cipher II system. All of the packagers of broadcast signals, such as Netlink and the Superstar Connection, have opted to use Video Cipher II. As the FCC and NTIA concluded in their inquiry report, "[T]he VC II has become the de facto standard for the satellite cable progamming industry in the United States." And the HSD marketplace has been well served by these developments,

Here is a rough description of how the Video Cipher II works. Each unit has its own identification number. A home dish owner wishing to subscribe to a service makes a call to that service or its agent, places the order, and specifies the identification number of the home unit. That number is then transmitted to the General Instrument facility in San Diego, which includes it on its satellite data stream and authorizes the unit to descramble the signal. The total time elapsed from the time the dish owner picks up the phone to the time the picture appears unscrambled on the screen is usually less than ten minutes.

As with many new businesses, particularly manufacturing businesses, there have been some startup problems and supply shortages of Video Cipher II units in the year and a half scrambling has been around. These have been caused in part by the difficulty in predicting demand for a product that has not existed before. Production was also slowed at one point because the pirates that still haunt the fringes of the dish industry had apparently compromised the system's security. General instrument tells us that experience has produced answers to both these problems. Since the Fourth of July, sales rates have doubled. More than 200,000 Video Cipher II units are in use and, at the current rate, that number will be 300,000 by October.

THE PROGRESS OF SCRAMBLING

To date, with the execption of broadcast "superstations" which are discussed separately below because of their special legal problems, six cable television services have scrambled, beginning with HBO and Cinemax on January 15, 1986, as follows:

Scrambled cable programming services

Service	*Date first scrambled*
Home box Office	January 15, 1986
Cinemax	January 15, 1986
Showtime	May 27, 1986
The Movie Channel	May 27, 1986

Service	*Date first scrambled*
Cable News Network & Headline News	July 1, 1986
ESPN	June 23, 1987

Each of these services makes itself available to HSD owners by telephone order.

In addition to there nationally available ordering opportunities, many cable operators are authorized to market the scrambled networks in the area of ther cable television franchises. In each case, however, the subscriber also has the option of ordering direct.

It is possible that other middlemen "on the ground" will emerge with time. I would only observe that a distributor "on the ground" can be justified from the consumer point of view only if that distributor provides real efficiencies in aspects of the distribution business such as promotion, customer service, billing and collection, as compared with the simple and efficeint national telephone ordering system now in place. To mandate distribution "on the ground" may be only to add a substantial layer of cost and complexity that must be borne by the consumer.

For example, mandating third party distribution to virtually all comers may result in programmers raising their prices to compensate for future potential losses and poor handling of the product by those inexperienced and inefficient distributors to whom they would have to sell. These "risk premiums" too would be passed on to the consumer.

In its inquiry report, the FCC notes the following Viacom International submission concerning the additional costs of establishing third party distribution mechanisms,

"If, however, in this early stage of development of the HSD market, SHO/TMC, were to license third parties who lacked that experience [that of cable operators], SHO/TMC necessarily would incur tremendous incremental costs in providing market support, in hiring an indefinite number of additional sales training and field marketing personnel, and in engaging in extensive educational and monitoring programs to ensure the proper handling of its product. These costs in turn necessarily would be passed on to the consumer."

Additional, unnecessary cost to consumers would frustrate a competitive marketplace that now offers cable programming to home dish owners at a lower price than it is available to cable subscribers.

THE "SUPERSTATION" PROBLEM

The distant broadcast "superstations" present a special case because of the condition of copyright law. Five "superstations" have been scrambled by the resale carriers that place them on the satellite, as follows:

Scrambled broadcast "superstations"

Service	*Date first scrambled*
WWOR	March 1986
WGN	January 1987
WPIX	March 1987
KTVT	March 1987
WTBS	March 1987

In order to understand the unique legal problems that attend the sale of scrambled superstations to home dishes, it may be helpful to review the legal framework under which those signals are provided to cable operators.

The Copyright Reform Act of 1976 gives cable television systems a compulsory license to retransmit the signals of television stations licensed by the FCC upon payment of copyright roylaties. The Act also provides an exemption from infringement action for common carriers that transport television signals and other protected works, so long as the carrier does not alter the content of the signal or exercise control over which signal is selected for transmission or who ultimately receives it.

It is the combination of these two provisions of the copyright law that allowed for development of superstations. Under the framework of the Copyright Act, cable operators engage the services of satellite resale carriers which, acting under the "passive carrier" exemption, deliver broadcast signals that could not economically be obtained by any other means. The satellite resale carrier does not select the signal to be delivered to the operator, nor does it have any control over who ultimately receives the signal.

The situation changes where home dish owners wish to purchase the signal from the satellite resale carrier. On March 17, 1986, Register of Copyright Ralph Oman discussed the legal significance of this change in a letter to Rep. Robert W. Kasten-

meier, Chairman of the House Judiciary Subcommittee on Courts, Civil Liberties, and the Administration of Justice. In his letter, Mr. Oman expresses the conclusion of the Copyright Office that the sale of scrambled superstaions to home dish owners by satellite resale carriers falls outside the scope of the "passive carrier" exemption. "Congress neither approved, implicitly or explicity, nor did it even contemplate this type of activity in granting the exemption to passive carriers . . . (t)herefore, I reach the preliminary judgment in this difficult and controversial area of law, that the sale or licensing of descrambling devices to satellite earth station owners falls outside the purview of section 111(a)(3), particularly where the carrier itself encrypts the signal. The exemption failing, the resale carrier requires the consent of the copyright owner of the underlying programming."

I should point out that a portion of the communications bar is in disagreement with Mr. Oman and is of the opinion that satellite resale carriers may sell directly to dish owners without infringement liability under current law. In any event, the copyright law is not totally clear in its application to the situation.

Despite the legal uncertainties that cloud the sale of broadcast signals to dish owners, a number of signals are available.

CONCLUSION

Considering the developments have taken place over only 18 months, I would say that this marketplace is developing nicely. HSD owners are buying the scrambled services. HBO/Cinemax has over 150,000 HSD subscribers. Showtime/The Movie Channel have 120,000 HSD subscribers, while CNN and Headline News have nearly 110,000 customers.

I would urge the members of the Subcommittee to bear in mind that very large numbers of program services, including many of the most popular cable services, are not scrambled and continue to be available to HSD owners for free. While some of these services may scramble in the future, others (including the cable industry's own C-SPAN and C-SPAN II) will remain unscrambled, providing HSD owners, unlike cable subscribers, with continued access to free service, and placing competitive pressure on prices charged to HSD owners for services that are scrambled.

Mr. Chairman, the first cable program network scrambled only 18 months ago, and to date fewer than a dozen have done so. More than 200,000 HSD owners are subscribing to the scrambled services, at prices below those paid by cable subscribers. The remaining dish owners, unlike cable subscribers, continue to receive a wide variety of satellite programming for free.

Price competition is taking place. When HBO and Cinemax first scrambled, the only price offered to HSD subscribers for both services was $19.95. Today a series of purchase options is available to HSD owners. HBO/Cinemax sell for a monthly rate of $14.96 in a prepaid annual subscription. Showtime/The Movie Channel are available for $15.50 for a similar arrangement. I should point out to the committee that the typical cable subscriber does not have this kind of discount pricing available for prepayment.

Home dish owners are reaping the benefits of this competition. Dish owners have access to all of the scrambled premium movie services at prices lower than those paid by the cable consumers for the same services. For basic cable program services, home dish owners get even a better deal. For $2.00 a month, they can get Cable News Network and Headline News. For another $2.00 a month, they can get ESPN. and, for $3.00 a month, they can subscribe to the Superstar Connection and get four broadcast superstations, more than generally carried on a single cable system. In other words, home dish owners can obtain all of the basic cable programming that has so far been scrambled for $7.00 a month and, of course, all of the unscrambled basic cable programming remains free. By comparison, the average cable subscriber must pay $12.69 per month for basic service and is limited to the program packages offered by the cable operator.

I should note, for purposes of comparison with more traditional media, that ESPN, which provides 24 hours of sports a day, is available for a $24.96 annual subscription, and that CNN and Headline News, which both provide 24 hours of news each day can both be received for a combined fee of $25. A subscription to the Washington Post cost $111.80 per year. A subscription to Sports Illustrated costs $56.68.

Cable programming is readily available to home dish owners at prices less than those paid by average cable subscribers for the same services. For example, dish owners can obtain a package of just basic service for $10.95 per month, a savings of 14% over the average $12.69 monthly price for basic cable subscribers. As I noted earlier, basic cable service plus Showtime costs dish owners $17.95 monthly, fully 22% less than the $23.13 average price cable subscribers pay for the same program-

ming. Both cable subscribers and dish owners can receive discounts for buying multiple premium programming services and the pattern of lower comparative rates for dish owners extends across these purchases.

Give this marketplace another 18 months, and the progress will be even more dramatic. Although I know it is not the intention of the bill's sponsors, enactment of S. 889 would likely stifle innovation and risk-taking in this new marketplace and choke its development. As the FCC found in its inquiry report issued last February 12,

"Based on the extensive information now available as a result of this comprehensive inquiry, we conclude that markets are evolving, that it appears likely they will prove efficient and workably competitive, and thus, that marketplace forces are likely to perform in the public interest without the need for intrusive and potentially debilitating government intervention."

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS

Question 1. Are there any program services that are scrambled but are not available to dish owners?

Answer. All cable program services transmitted via satellite in the C-band are available to dish owners. (Although satellite transmissions are made on a variety of frequencies, almost all video programming is sent on the C-band and more than 90% of dish owners have tunning equipment capable of receivng only C-band transmissions.) One scrambled broadcast "superstation" is not available to dish owners because its sale could be interpreted as a violation of the Copyright Act. There may be a number of video transmissions of programmers not affiliated with the cable industry, such as those of broadcast networks and PBS, which are not available to dish owners.

There is one, new, scrambled Ku-band cable program service which is not offered to dish owners. In May, Home Box Office launched its new "Festival" service, comprised of predominately "G" and "PG" rated movies. HBO did not initially plan to offer Festival to dish owners for several reasons. First, less than ten percent of existing backyard dishes are capable of receiving Ku-band satellite transmissions. Second, Festival is designed specifically for consumers who have not been interested in buying existing pay television services. HBO's experience demonstrated that dish owners are not in this category. Finally, the promotion, billing, descrambler authorization, satellite transponder, and other costs associated with providing Festival to dish owners would be significant. HBO did not believe that the potential audience for Festival among dish owners justified these costs.

The Satellite Broadcasting and Communications Association urged HBO to reconsider the availability of Festival to backyard dish owners and, based in part upon this request, HBO has begun a series of market research studies to reconsider Festival's viability with dish owners. HBO has stated that if there is demand for Festival among dish owners sufficient to justify these added expenses, HBO would be anxious to satisfy that demand.

Question 2. Has Congress ever passed a statute that guarantees people the right to receive or become the distributor of programming similar to HBO, ESPN, Showtime or traditional television type programming?

Answer. This question is really three questions. In order to provide the Committee with a thorough and proper answer, it is necessary to address each element individually.

First, to our knowledge, Congress has never passed a law guaranteeing the right of anyone to receive video programming, regardless of the technology used to distribute it. We would note, however, that despite the absence of such a law, the American public today has access to a greater diversity of information sources and services than it has ever had, and indeed, that diversity is greater than many even imagined would occur just a few short years ago.

To our knowledge, Congress has never passed a statute guaranteeing anyone the right to become a distributor of video programming (or any other intellectual property) sold to the public. There is no statutory right for any cable operator, for example, to be a distributor of HBO, ESPN, Showtime, or for that matter, to be an affiliate of NBC, CBS or ABC. There is no statutory right for a particular movie theater to be a distributor of any given movie. There is no statutory right for any video cassettee store to be the rental distributor of any particular video cassette. There is no statutory right for brodcast networks to be distributors of any particular movie, program, or sporting event.

The situation changes when the question shifts from a right to distribute pay television programming for sale of the public, to a right to distribute television programming customarily offered for free to the public. In the latter instance, cable was granted a compulsory license under the Copyright Act of 1976 to retransmit the signals of broadcast television stations. This statute was passed against the backdrop of a whole list of cable-restrictive regulations promulgated by the FCC under the Communications Act.

First, cable was, and continues to be, required to be a distributor of local broadcast signals as a result of the FCC's must carry rules.

Moreover, the compulsory license was and continues to be subject to a range of protections for broadcasters. For example, networks can demand non-duplication protection for their affiliates. Cable operators also cannot alter the content of the broadcast or change or replace the commercials. As noted in the answer to the next question, the FCC is considering some form of reimposition of syndicated exclusivity, which could result in wholesale deletion of programming available to cable subscribers.

Question 3. Will the reinstatement of the syndicated exclusivity rules by the FCC have any effect on home dish users?

Answer. NCTA has submitted comments vigorously opposing the Commission's proposal to reinstate syndicated exclusivity regulation. Among the reasons for our opposition are (1) that the Commission lacks jurisdiction to adopt syndicated exclusivity rules and (2) that syndicated exclusivity regulation will not serve the public interest and, indeed, will have a decidedly negative impact on the 43 million households that have elected to subscribe to cable service.

Our analysis of the impact of syndicated exclusivity rules has been hampered considerably, by the Commission's release of a combined NOI/NPRM that does not present actual proposed rules. Therefore we have no choice but to make assumptions in our analysis based largely on the Commission's former rules repealed in 1981.

In the event that syndicated exclusivity rules applied to backyard dishes, all blackouts would need to be initiated at the point of uplinking the signal. Presumably this would have to be done by the satellite resale carrier or its agent. The Commission's NOI/NPRM suggests that the right to request syndicated exclusivity blackout protection would rest with both broadcasters and copyright holders. Therefore all broadcasters from all markets would have to notify the common carrier of the scheduling of the programming subject to deletion. Furthermore any copyright owner seeking syndicated exclusivity protection would need to notify the satellite carrier of the programming to be deleted. Hundreds of broadcasters and copyright holders could require the common carriers to blackout their respective market areas or programs dozens of times each day. The VideoCipher II scrambling technology can address only a limited number of specified areas at any one time. Therefore it is impossible to create a blackout system which could address all of the blackouts requested at different times. The likely result would be satellite carriers blacking out all of the programming to backyard dish owners for which syndicated exclusivity blackouts were requested, without regard to the location of the backyard dish. The viability of a marketplace for distant signals to TVRO's would therefore be called into serious question.

We further note that if the blackout rules were similar to those in effect in 1980, and the authority to request blackouts was vested with both the copyright owner and the broadcaster, the utility of distant signals to cable systems would be significantly eroded. Many operators would probably drop the distant signals altogether. In that event the question would have to be asked by the common carriers as to whether or not there is a real business left. If the judgment were that transportation of distant signals to cable systems had lost value, and carriers could not turn a reasonable profit, they would logically drop the carriage of some distant signals. This would affect both cable subscribers and TVRO owners.

Senator GORE. Thank you very much. We will have many, but we will hold them.

Mr. Bert Carp is our third witness, vice president for government affairs with Turner Broadcasting Systems, Incorporated, also here in Washington. Mr. Carp, welcome.

STATEMENT OF BERT CARP, VICE PRESIDENT, GOVERNMENT AFFAIRS, TURNER BROADCASTING SYSTEM

Mr. CARP. Good morning, Mr. Chairman and members of the subcommittee. I am Bert Carp, Vice President for Public Affairs of Turner Broadcasting System.

Turner Broadcasting owns and operates three satellite networks: CNN, Headline News, and Superstation WTBS. CNN and Headline News were the first basic cable networks to scramble, and from the beginning Turner Broadcasting has marketed these services aggressively to the home dish market.

So far we have signed up about 130,000 home dish subscribers to CNN and Headline News from the 200,000 dish owners who have so far acquired descramblers. About 34 percent of these subscriptions have come direct through our national 800 number.

About 16 percent have come in through our joint marketing arrangements with HBO and Showtime, and about 17 percent have come in from cable operators; 21 percent of our sales have come from home dish manufacturers, wholesalers, and dish dealer affiliates.

I should note that about a third of our cable system affiliates have accepted our offer to market programming to home dishes.

I think the record will show that Turner Broadcasting has made a very vigorous effort to sign up home dish owners and we are going to continue that effort. Just last month, for example, TBS entered into an agreement with the National Rural Telecommunications Cooperative to market our services in conjunction with rural cooperatives around the country.

Mr. Chairman, I know this committee wants to know why there are not more competing packages being sold to home dish owners. We at Turner Broadcasting think there are two main reasons.

First, most cable networks have not scrambled. They are still available over the air for free, and as a practical matter they cannot be effectively marketed as part of a package. The one thing we think that would help most is for additional services to scramble.

Second, most of the services that are scrambled are broadcast superstations. The marketing of these signals has been adversely affected by uncertainties in the copyright law, uncertainties that would be corrected by the Kastenmeier-Synar bill which is now pending in the House Judiciary Committee.

These two factors—a shortage of scrambled networks to sell and copyright problems regarding the superstations—are the reasons that this spring TBS gave up its own exploratory plan to sell a package.

Mr. Chairman, we urge adoption of legislation along the lines of the Kastenmeier-Synar bill to clearly allow marketing of superstations to home dish owners. We urge that further regulatory legislation not be enacted at this time. For reasons explained at greater length in my prepared testimony, we think that enactment of legislation now would do more to hinder development of this marketplace than it would to help it.

Thank you, Mr. Chairman.

[The statement and questions follow:]

STATEMENT OF BERTRAM W. CARP, VICE PRESIDENT FOR GOVERNMENT AFFAIRS, TURNER BROADCASTING SYSTEM, INC.

Mr. Chairman, members of the Communications Subcommittee, I am Bert Carp, Vice President for Government Affairs of Turner Broadcasting System, Inc.

Turner Broadcasting System owns and operates three satellite-delivered program services: Superstation WTBS, Cable News Network and Headline News. Turner Broadcasting also owns and operates the Atlanta Braves National League baseball team, the National Basketball Association Atlanta Hawks, and markets the MGM film library and other programs owned by TBS to broadcast, cable and home video.

Turner Broadcasting established the first satellite-delivered basic cable channel. TBS was first to scramble a basic cable network, and first to sign up back-yard dish owners as subscribers to basic networks. TBS' experience is particularly relevant to the subject matter of today's hearings, and we are pleased to testify.

BACKGROUND

In 1970, Ted Turner acquired WJRJ, a UHF broadcast station located in Atlanta. The station's call letters were changed to WTCG, and later to WTBS. In 1970 there were no "basic" cable channels designed to be provided along with local broadcast stations as part of the operator's lowest-cost service. In fact, there were very few independent broadcast stations in the south outside Atlanta. Turner was the first to understand this marketplace, and to act: encouraging cable systems to carry WTBS and in turn urging advertisers to take advantage of the expanded audience.

By mid-1976, nearly one hundred cable systems with over 400,000 subscribers in four southeastern states carried WTBS. Some of these cable systems used sophisticated antennas to pick up WTBS' off-air broadcast signal. Others contracted with microwave common carriers to bring in the signal. But TBS's potential audience was limited by microwave and off-air technology to the area within a few hundred miles of Atlanta.

Turner saw that satellite transmission of WTBS could give the station a national audience. In December 1976, Southern Satellite, a satellite resale common carrier, began distributing SuperStation WTBS to cable systems, and the first satellite-delivered basic cable service was born.

SuperStation WTBS was the first national basic cable network. But unlike many of its successors, WTBS is also a broadcast station, and is therefore subject to a complex set of rules with respect to copyright. Under the terms of the copyright law, Turner Broadcasting is allowed to market WTBS to cable systems as a national "superstation", and to sell national advertising. But the law does not permit the insertion of local advertising by cable operators into broadcast signals like WTBS. Moreover, while TBS can sell national advertising on WTBS and can encourage cable carriage of WTBS' signal, TBS is not allowed to charge any additional fee to cable systems for carriage of WTBS. Unlike other basic cable networks, as a superstation WTBS must be completely advertiser-supported.

Southern Satellite, the common carrier which is and under the law must be independent of TBS, does recover a transmission fee from cable operators. And under the 1976 Copyright Act, cable operators pay an additional copyright fee as extra compensation to the copyright owners of programs transmitted on WTBS.

Over the last few years, SuperStation WTBS has grown to a national service reaching over 40 million homes, with nearly one fourth of its schedule devoted to its own original programming and an annual program budget of over $100 million.

WTBS was first, but it was not Turner's last contribution to the evolution of cable programming. On June 1, 1980, TBS launched the Cable News Network to deliver 24 hours of news daily to basic cable subscribers. Each of the major news networks had considered establishing a cable news channel—and dismissed the idea as impractical. CNN began with fewer than two million subscribers, and for five years the new network sustained what the New York Times recently described as "harrowing losses"—kept alive by Turner's determination and the infusion of revenues from WTBS.

Today CNN has 1,500 employees, and reaches 41 million households. The network has nine domestic and nine foreign bureaus; this fall CNN will add bureaus in Paris and Beijing. In 1982, TBS established a companion service, Headline News, to provide continuous twenty-four hour coverage of the top stories of the day.

Recent audience research has found that CNN and Headline News together capture a 21 percent share of national news viewing in the U.S. Much of their popularity is a result of innovative, often revolutionary news programming. CNN was the first American network to air live national coverage of both civil and criminal trials; and the only network to air live continuous coverage of this summer's Iran/

contra hearings. Its commitment to take viewers live to the scene of breaking news and to stay with the story as long as necessary has resulted in record audience levels in times of national crises, such as the hijacking of a TWA flight to Beirut or the Challenger shuttle explosion. This type of comprehensive, quality coverage has earned the network every major award in broadcast journalism.

After years of effort, CNN and Headline News are profitable—as they need to be to survive. But equally important, these networks perform a public service, providing crucial information to millions of Americans. And perhaps CNN and Headline News point the way to future television innovations as they demonstrate that cable networks can do more than just mimic traditional broadcast TV.

SCRAMBLING

CNN and Headline News were the first basic cable networks to scramble—in July of 1986. TBS moved to scramble as quickly as the Videocipher II technology emerged as the industry standard, for a simple reason. CNN and Headline News are supported 45% by advertising and 55% by subscriber fees. For years they have been plagued by "free riders"—not just home dishes, but businesses like hotels, motels and bars—who have received CNN and Headline News for free while cable subscribers have paid. Scrambling is the only effective way to make sure that those who use means other than cable to receive CNN and Headline News also pay.

For TBS, the purpose of scrambling is not to exclude anyone, but to include as many paying subscribers as we can. Today nearly two million U.S. households have home dishes, and dish sales are running 15,000–20,000 per month. From the inception of scrambling TBS has viewed dish owners as a key market for CNN and Headline News.

I should point out that although Turner Broadcasting has aggressively marketed CNN and Headline News to home dish owners, TBS does not control either the scrambling of SuperStation WTBS or its marketing to home dish owners. Under the copyright laws, the decisions with respect to scrambling of SuperStation WTBS must be made by the common carrier Southern Satellite, now renamed TEMPO, and not by WTBS. WTBS is presently scrambled in the fixed-key mode, which means that its service can be received at no charge through any home dish which is equipped with a discrambler.

Beginning in late 1985, before CNN and Headline News scrambled, TBS offered its cable affiliates non-exclusive distribution rights, which allow them to sell CNN and Headline News to home dish owners in and near their cable franchise areas. To date, approximately 30% of TBS' cable affiliates are involved in marketing to home dish owners.

In May 1986, also before scrambling of CNN and Headline News took place, TBS opened its own consumer order center to make CNN and Headline News available nationwide to home dish owners through a toll-free number. TBS sells both services combined for $25.00 a year, a little over $2.00 a month and less than a quarter of the $111.80 annual cost of a Washington Post subscription.

On June 30, 1986, TBS authorized HBO to sell CNN and Headline News concurrently with HBO/Cinemax, and on July 30, 1986, TBS authorized Showtime to market CNN and Headline News with Showtime/The Movie Channel. CNN and Headline News are included in the $10.95 monthly package of basic service ($7.00 with subscription to Showtime or The Movie Channel) announced by Viacom Satellite Networks.

TBS has entered into arrangements with manufacturers and wholesalers of home dishes and descramblers under which equipment purchasers receive free or discounted subscriptions to CNN and Headline News. At present TBS has such arrangements with over 20 companies.

TBS has worked hard to involve retailers of home dish equipment in the sale of CNN and Headline News. At present over 2,500 home satellite equipment retailers are engaged in selling CNN and Headline News.

And last month TBS entered into an agreement under which the National Rural Telecommunications Cooperative, affiliated with the National Rural Electric Cooperatives Association, will include CNN and Headline News in a package of program services which NRTC is marketing to home dish owners in conjunction with rural cooperatives around the country.

To date TBS has acquired about 130,000 home dish subscribers to CNN and Headline News. About 34% of these subscribers have come directly through TBS' own Consumer Order Center, 16% have come from Showtime and HBO, 31% from equipment manufacturers and retailers, and 17% through cable operators. The remaining

2% mainly consists of free subscriptions provided for the showrooms of equipment retailers.

Mr. Chairman, I believe the record shows that TBS has pursued the home dish market aggressively. Nevertheless, as you are aware, we have suffered an important and visible disappointment.

Last fall, TBS began to explore the feasibility of a package of services to be offered to the home satellite dish market by national telephone order and also through equipment wholesalers and retailers.

By May of this year, TBS was in a position to offer the following cable satellite services:

Black Entertainment Television
CBN*
CNN*
Country Music Television
The Discovery Channel
Headline News*
Hit Video USA

In addition, TBS planned to offer the following satellite broadcast signals:

Netlink USA—KCNC*; KMGH*; KSPN*; KDUR*; KRMA*; KUSA*.
Superstar Connection—WGN*; WPIX*; KTVT*; WWOR*.

The services which are scrambled are marked by asterisks.

It is readily apparent that while TBS could offer thirteen scrambled program services, ten of these are satellite-distributed broadcast signals, and two, CNN and Headline News, are services already offered by TBS. Unscrambled signals are of little value in a package, since they are available free to anyone with a home dish. The commercial viability of a TBS programming package, therefore, rested on its ability to include broadcast signals—and here is where the copyright law comes in.

As a lawyer, I am perfectly prepared to argue that it is legally appropriate for TBS to market satellite-carried broadcast signals. But it is nevertheless clear that under the copyright law there is a substantial question, which may at some future time be resolved by the courts, whether the marketing of a scrambled, satellite-carried broadcast station to a home dish owner is lawful.

On March 17, 1986, Registrar of Copyrights Ralph Oman discussed this issue in a letter to Chairman Robert W. Kastenmeier of the House Judiciary Subcommittee on Courts, Civil Liberties and the Administration of Justice. The letter, states in part as follows:

"Congress neither approved, implicitly or explicitly, nor did it even contemplate this type of activity in granting the exemption to passive carriers . . . Therefore, I reach the preliminary judgment in this difficult and controversial area of law, that the sale or licensing of descrambling devices to satellite earth station owners falls outside the purview of Section 111(a)(3), particularly where the carrier itself encrypts the signal."

Chairman Kastenmeier, together with Rep. Mike Synar, has introduced H.R. 5935, the Satellite Home Viewer Copyright Act of 1987. This legislation would expressly authorize the sale of satellite-delivered broadcast stations to home dish owners. But Congress has taken no action on the Kastenmeier-Synar bill, and in the meantime, the copyright law establishes very substantial penalties for the unauthorized distribution of protected material. Therefore, in the absence of clarifying legislation, in our view the legal risks of marketing satellite-distributed broadcast signals to home dish owners are too great, especially for a company which, like TBS, itself operates a satellite superstation.

Without the broadcast signals, and given the small number of basic cable services which have scrambled, there was last May and there is today simply no opportunity for TBS to offer a package of programs to the home dish market. In a nutshell, it is these two factors, the copyright legal issue and the number of scrambled satellite networks, which caused TBS to announce last May it would not proceed to offer a program package.

CONCLUSION

Mr. Chairman, in our view, the main problem for potential packagers is that too few networks have scrambled. You can't package and sell unscrambled satellite networks that people can get for free. The one thing that would help the most would be more scrambling. That, and that alone will create the conditions for vigorous competition.

We recommend adoption of legislation along the lines of the Kastenmeier-Synar bill, which would make additional scrambled programming available to the dish

market. We recommend against adoption of S. 889 at this time. Although we support its goal, we believe the practical effect of the legislation would be to hinder, not to help, the development of a competitive marketplace.

Satellite networks are likely to be less enthusiastic about selling to home dish owners if they are subject to regulation which restricts their ability to select their own distributors. The result may be to reduce the networks' commitment to aggressively develop and promote the home dish marketplace.

Equally important, we believe that distributor incentives to promote and market aggressively would be hard to establish within a regulatory structure which may cause a multitude of mandated distributors to believe their business interest lies in seeking a "free ride" from the promotional activities of their competitors and of the networks themselves.

Mr. Chairman, in any event TBS will continue to fully and vigorously market our networks to the home dish market. In the not-too-distant future, TBS would like to see CNN and Headline News in every American household. Signing up two million home dish owners is an important part of achieving that goal.

Thank you.

QUESTION OF SENATOR INOUYE AND THE ANSWER

Question 1. Will the reinstatement of the syndicated exclusivity rules by the FCC have any effect on home dish users?

Answer. Yes. As an economic matter, satellite carried distant broadcast stations, or "superstations", are primarily supported by their cable audience. Reimposition of syndicated exclusivity rules would force cable operators to "black out" a substantial share of the programming carried on superstations. This process is burdensome to the cable operator and renders the distant signal far less attractive to cable subscribers.

In all likelihood, reimposition of syndicated exclusivity rules will cause cable operators to sharply reduce carriage of superstations. In that event, a number of these stations are likely to be removed from satellite carriage and therefore lost to home dish owners as well as cable subscribers.

Senator GORE. Thank you very much.

Our next witness is Mr. Frederick Finn with Brown & Finn here in Washington, DC.

STATEMENT OF FREDERICK W. FINN, BROWN & FINN, WASHINGTON, DC

Mr. FINN. Thank you, Mr. Chairman. Mr. Chairman, members of the subcommittee:

Thank you for the opportunity to appear before you today on behalf of the Home Satellite Television Association. I would like to thank also the listeners to the KSAT satellite-delivered radio service for their assistance in the preparation of my remarks.

HSTA is made up of consumers and retailers of home satellite antennas across this country. The marketplace for the delivery of satellite communications to the home is in a state of shambles. Consumers are confused, frustrated, and angry.

They are not buying home satellite antennas. Sales are down 80 percent in 2 years. Thousands of retailers, over 60 percent of the industry, have been forced out of business.

Consumers do not understand why, after 18 months of scrambling, they cannot buy full packages of programming from competitive sources, the same way they buy other goods and services. They do not understand why one company has a monopoly over the descrambling hardware, why there are periodic shortages of that hardware, why its cost is so high and has in fact gone up over time, unlike every other item of consumer electronics.

They do not understand why non-elected government officials in Washington blindly preach that the marketplace is working when it is so obvious to them in the field that it is not.

The largest cable television companies are manipulating it. These companies control, directly or indirectly, every one of the major satellite services, every one. They are ensuring that satellite services sell programming to dish owners only so as not to harm the cable industry.

We see this in the recent letter from Daniels, a cable operator, to Showtime complaining that the latter's marketing to dish owners was too aggressive and might undercut its cable monopoly.

We see it in the actions of Turner Broadcasting, which withdrew from the packaging business just as soon as it was taken over by TCI and the other major MSO's.

Wall Street sees it also. As dish sales have nosedived, the value of cable systems has increased 66 percent in 1 year alone—66 percent.

Wall Street is sending a message: A deregulated cable industry has no real competition.

An independent-of-cable satellite to home industry is important to rural Americans. It is also important to cable subscribers because competition from direct satellite to home communications presents the best chance, the best chance of keeping cable rates down.

It is important to all Americans who believe that the maximum access to communications is necessary for a healthy democracy and see that access being manipulated more and more by a few companies.

Last year the Senate nearly passed legislation. The opponents said it was too soon, let the marketplace work. We say if these problems are not remedied this year it may be too late, too late for an independent of cable satellite industry, too late for the consumer, who will be denied a competitive choice.

We strongly support S. 889 and urge its passage. It is the consumer's best hope and will likely be the consumer's last hope.

Thank you, Mr. Chairman.

[The statement and questions follow:]

Testimony of Frederick W. Finn

Mr. Chairman, Members of the Subcommittee, and Staff, thank you for the opportunity to appear before you to discuss issues which are critical to the future of television viewing in our country. I am a member of the law firm Brown & Finn, Chartered and am appearing before you today on behalf of The Home Satellite Television Association ("HSTA"). HSTA is the primary association of retailers and owners in the home satellite earth station field. I would also like to thank the listeners of the K-SAT satellite-delivered radio service who are HSTA members, and who assisted in the preparation of this testimony. In these Comments, I have not addressed in detail the issues concerning availability of network, PBS and Armed Forces signals to Americans. These topics will be addressed by Ms. Diane Davis, a consumer in Arkansas, and HSTA supports her comments.

You have asked us to address the current state of the marketplace for the delivery of satellite services to the home. That marketplace is in a state of shambles. After nearly eighteen (18) months of scrambling, there is no universally-available full package of programming. The one that touts itself as a full package is incomplete and marked with defects and uncertainty. While some large cable television multiple system operators (MSOs) are themselves offering a package of programming to dish owners in, or next to, their franchised areas, these are not competitively priced. Cable television companies neither compete with other cable television companies for cable service nor for service to dish owners. Exclusivity provisions prevent one cable operator from competing for sales to dish owners with other cable television operators.

Some satellite services provide their programming directly to dish owners, a la carte, but they do so at a price of up to six times or more the fee charged to cable systems. The consumer wishing to view multiple services must make multiple telephone calls. A few of the major theatrical motion picture services have announced monthly

rates which on their face appear equal to or slightly less than their rates for cable subscribers. What they fail to tell is that to obtain these "favorable" rates typically requires the consumer to pay one full year in advance and take several channels which the consumer may not desire. Also they fail to mention the fact that included in the rate cable subscribers pay is a large charge of several dollars or more for getting the signal to the subscriber's home over the coaxial cable. A dish owner has already purchased his delivery system, i.e., his satellite dish, for several thousand dollars. Therefore, his fees should be far less than what cable subscribers pay. Finally, the quoted rates do not include the exorbitant prices for the descrambler of $395-$600 if one can be found.

No independent-of-cable or "third-party" packagers have been able to develop a significant package of programming although many have tried. Those who have tried and failed include Home Satellite Systems, Inc., the Amway Corporation and The National Rural Electric Coop. Turner Broadcasting tried to put together a package of over twenty signals for sale to dish owners all over the country. Those plans were abandoned as soon as real control of that company passed into the hands of TCI and the other multiple system operators (MSOs). Another threat to the MSOs' monopoly was extinguished. Absent the existence of independent-of-cable packagers that have a real incentive to aggressively pursue this market, real competition in the delivery of satellite service to residential consumers may never exist.

Even the basic question of access by home dish owners to satellite programming is in question with the recent indecision of HBO whether to sell its new Ku-Band services to home dish owners. Consumers are almost back to where they were a half decade ago fighting for basic access to satellite programming.

There is even less competition on the hardware side of the industry. General Instruments has, in effect, a monopoly over existing scrambling technology through the choice by the major satellite services of its decoder, the VideoCipher II, encryption

technology. Unlike virtually every other item of consumer electronics, there has been no reduction in prices for the VideoCipher II since its introduction nearly two years ago. In fact, the distribution price has recently gone up. This week General Instruments announced that it paid twenty million dollars to settle a law suit over this device. Who will pay for that? The consumer of course. Because of General Instruments' position as a monopoly supplier, the consumer has no other choice.

Despite early denials by both General Instruments and the FCC, there have been, and are now, critical shortages in the delivery of the VideoCipher IIs and integrated receiver decoders (IRDs). As a result, consumers are confused. An illegal black-market industry has flourished and legitimate retailers have been driven from the field. Retailers should not have to choose whether to be a pirate or go out of business. HSTA members have been severely harmed by piracy problems. Until the consumer is able to conveniently obtain hardware and programming packages at rates determined by open competitive forces, there will be piracy problems.

Sales of home satellite antennas have dropped since 1985 from a high of 80,000 per month to a figure between 20,000 and 25,000 per month in 1986, and between 15,000 and 20,000 for the first quarter of this year. Last month the figure dropped again to barely 14,000 per month. 1/ Nationwide, over 50% of home satellite earth station sellers have been forced to close their doors. In some areas 80% of dealers are no longer in business. Most of those still in business exist on upgrade or retrofit and the sales of products other than home satellite equipment. Manufacturers have been hard hit with some well-known names filing for bankruptcy or otherwise terminating operations this year.

1/ Satellite Times, June 17, 1987, page 1.

But hardest hit of all is the consumer. Consumers who own earth stations do not understand why they have difficulty obtaining programming in packages and why they are required to pay many times more than cable companies pay for programming. Cable consumers are themselves harmed by being denied the competitive choice which direct satellite-to-home technology provides. This denial is particularly harmful because it comes at a time when the rates for cable service have been deregulated by the Congress. Competition from home satellite earth stations could serve as a regulator of cable consumer rates by offering the consumer an alternative. Today he or she has no alternative. Wherever he or she turns there are the hands of the nation's largest cable companies seeking to retain and expand their monopolies. To see how we arrived at this state of affairs some history is in order.

The Marketplace in Perspective

This is at least the fifth year that the Senate Commerce Committee has been involved in issues related to home satellite television antennas. Three years ago, as a result of hearings, Congress passed The Satellite Viewing Rights Amendments which were included within the Cable Telecommunications Policy Act of 1984. Those Amendments clarified the basic legality of the home satellite industry and the use of satellite earth stations. This use had previously been called into question by some satellite programmers.

In the early 1980s, some of the major program suppliers sent letters to the manufacturers of home satellite earth station antennas threatening them with lawsuits for merely manufacturing satellite reception antennas. When some home satellite antenna owners sent checks to HBO for viewing of its signal, these checks were returned with a letter stating that HBO only dealt with cable television companies and that if the viewer wanted to watch HBO, he or she had to contact the local cable television company (even if there was none in the area or it did not carry HBO). One cable

operator, a large media conglomerate, sued a home earth station dealer in an attempt to stop him from selling home satellite reception equipment.

Despite these efforts, consumer acceptance of home satellite antennas grew. The overwhelming majority of sales were made in areas without cable service. For the first time millions of Americans located in rural areas were able to access the same programming as urban and suburban Americans. By the fall of 1985, the number of home satellite antennas going into the marketplace reached 80,000 per month. However, by the spring of 1986 all this had changed. In January of that year, HBO initiated scrambling of its signal.

It should be noted at this point that the overwhelming majority of dealers and consumers recognize that scrambling is a legitimate means to ensure payment for viewing of subscription services. The issue is not scrambling. If no one paid HBO for its service there would not be an HBO service. The issue is the establishment of an open and fair marketplace and the emergence of real competition which will result in payment of a fair fee.

Simultaneously with the introduction of scrambling, there appeared negative advertising pieces in newspapers and television reports all of which were designed to dissuade consumers from purchasing earth stations. In most cases, the advertising was bought and paid for and the stories appeared planted by cable television operators, often the largest MSOs. An HBO executive was quoted as saying the skies would go dark. In fact, part of the campaign was orchestrated by one of the cable industry's major trade associations.

HSTA believes that the drop in sales, and the consumer confusion has resulted primarily from the pressure placed by the nation's largest MSOs on the scrambling, pricing, and distribution decisions of the major satellite services. The marketplace is most definitely not working — that is unless you are a major cable television company —

in that case it is working just fine. The sale of home satellite antennas is down 80% in the last 16 months. As a result of Congressional deregulation and isolated from the competitive threat of direct home satellite television reception, cable television operators have seen the price which buyers are willing to pay for their systems grow dramatically from $1,200 to $1,500 just a year ago to $2,000 today.

The Distribution of Satellite Programming

Because of their economic leverage over the providers of satellite programming, the nation's largest cable television companies have a strangle-hold around the neck of the American consumer. The cable television industry, recently deregulated by Congress, has effectively controlled the growth of home satellite antennas by controlling satellite programming as shown below.

Seeing the potential for competition posed by home satellite antennas several years ago, the cable television industry made it very clear through spokesmen from the largest cable companies at its national trade association meetings and elsewhere and by the creation of an NCTA-sponsored consortium to encourage scrambling that it wanted control of the distribution of programming to home earth stations. The major MSOs are able to exert great influence over the programming market. The major MSOs have a virtual veto power over the pricing and practices of the major satellite services. In some cases, like HBO, Cinemax, ATC, Showtime/The Movie Channel, MTV, Video Hits One, Nichelodeon and Viacom, the satellite programmers and cable companies are owned in common. In other cases, such as ESPN, virtually the only purchaser of programming is the cable industry.

The largest MSOs are able to bring great influence on how that programming is distributed. Recent reports point to it being more than just coincidence that ESPN has withdrawn its packaging plans and has decided to sell its services to home dish owners through cable companies as TCI has urged and TCI's decision to contract for carriage on

its systems of the ESPN N.F.L. package. It is also more than a coincidence that as soon as TCI acquired a major stake in Turner Broadcasting, Turner withdrew its packaging plans.

Most satellite networks, whether pay television or basic, are only marginally profitable or have not yet become profitable. If the top MSOs were to remove a particular cable programming network from their cable systems, that network would suffer a severe economic set-back and many would be put out of business. Similarly, a carriage agreement between a major MSO and a programming service can protect that service from a competitive entity. Recently Turner and TCI contracted for the carriage of CNN Headline service pulling the rug on a potentially competitive news service being considered by NBC.

So it is not surprising that when the word went out from cable leaders to programming networks to scramble and to be "cable friendly" that is exactly what happened. The term "cable friendly" means not only to scramble, but to sell programming to dish owners through the cable operator or in such a manner as not to interfere with the cable operator's investment in his cable plant. While most agreements to sell to dish owners through cable have been non-exclusive, they are non-exclusive in theory only. The major satellite subscription services have chosen not to engage in wholesale distribution with any independent-of-cable distributors or earth station retailers or to even set up the criteria under which any independent-of-cable party could qualify to distribute their programming.

In most cases, cable television operators simply do not have the incentive to aggressively market programming to home dish owners within their franchised areas. To do so would be to undermine their own investment in their cable plant. Even in those few cases in which a cable operator has determined to market programming at a price equal to or slightly less than the rate he charges cable subscribers, unless real competition in

the form of a third-party, independent-of-cable packager of programming exists, there is nothing to prevent that cable operator from raising prices to home satellite dish owners in the future, confident in the knowledge that consumers have no other real alternative.

Many consumers who buy home satellite antennas do so because they do not like the quality and quantity of service they are receiving from their local cable affiliate. It makes no sense for consumers who are dissatisfied with cable to have to buy programming from cable. Showtime/The Movie Channel does not sell to independent-of-cable third parties. Neither does HBO, Cinemax, Disney or ESPN. Unless these practices are changed, the home satellite earth station industry will exist, if at all, as a poor stepchild of the cable television industry. The consumer will be denied the choice which technology has provided.

The artificial constriction in the marketplace may be seen by two examples. One taken from the "TCI plan" and one from the "NRECA plan." Both plans have been touted as examples of how home satellite earth station owners can gain fair access to satellite programming. Neither plan accomplishes this goal.

The TCI Plan

When TCI purchases, for example, CNN for retransmission to its cable television subscribers, it pays no more than $.20 per subscriber per month. Even the smallest non-MSO systems pay no more than $.24 per subscriber per month. TCI has agreed to pay for the exact same service for resale to home dish owners the fee of $1.00 per subscriber per month. As the nation's largest MSO, TCI certainly has great leverage in its negotiations. So why did it agree to pay at least five times as much for the identical service? The answer is that by paying more for home dish viewers than cable subscribers, TCI ensures that home dish owners will have to pay more than cable subscribers for the identical service. Thus, it protects its cable monopoly. Consumers will not likely put a dish in the TCI area if they have to pay more for the programming

than cable subscribers do. It also sets a floor for others who purchase the CNN programming for resale to home dish owners. By agreeing to pay $1.00, TCI ensures that if other non-cable parties are able to purchase CNN for redistribution, the rate they will be forced to pay will be high enough so as not to undercut the cable retailer rate.

The reason why cable wants to stifle or control the sale of home satellite antennas is that they reduce the number of potential cable subscribers and, in fact, may even take away existing cable customers who disconnect when they purchase a home earth station. The cable subscriber currently valued at $2,000 is more valuable to a cable operator than an earth station subscriber. This is a substantial asset of the cable operator who has every incentive to protect it. He has little desire to see dishes proliferate in his franchised area. Unless there is an independent program distribution mechanism established to compete with the cable operator, cable operators will be able to stifle earth station competition inside and outside their franchised areas.

The nation's largest MSO has been active in other areas. In the recent past, TCI has made a substantial acquisition of Netlink USA, a company which uplinks six Colorado broadcast stations. It is negotiating with the networks directly in an attempt to provide network television to dish owners and last month agreed with NBC to bring that network's programming when scrambled to certain limited "white areas." That agreement sets the precedent for service by cable. If the networks are available by means of cable, then the home satellite antenna owner is denied service. TCI has purchased a significant portion of Turner Broadcasting System, which provides the only source of non-broadcast news to cable subscribers and dish owners. It was reported to be in negotiations to control Showtime/The Movie Channel. TCI and the other top four MSOs already control, directly or indirectly, 41% of all cable television subscribers.

This giant MSO is seeking to control the future of not just the cable television industry, but of the delivery of all programming to the home by means of satellite. If

allowed to succeed, this plan will have a profound impact on consumer choice and the way Americans will receive their information well into the 21st century. The time to avert these potential problems is now, by opening up the marketplace for delivery of satellite programming services to real competition.

The NRECA Plan

Last year representatives of home dish owners and consumers testified that the major satellite subscription services had been unwilling to license the sale of their programming at cable-like rates to any entity unaffiliated with franchised cable television operators. This situation remains unchanged. Over a year ago, The National Rural Electric Co-op testified that it was putting together a full package to provide to dish owners around the country. This was used as a reason by some to argue against the need for legislation at that time. After over a year of negotiations, that plan is still far from complete. NRECA has rights to only a few non-broadcast services, most notably CNN and CNN Headline News. It has been suggested that these were ony acquired from Turner Broadcasting to keep the heat off TCI when it forced Turner Broadcasting to withdraw from the packaging business. It is not certain how long CNN and Headline News will be included in the NRECA "package." After a year, the NRECA "package" does not include a single major theatrical motion picture subscription service. As admitted by cable interests in hearings last year, such a service is the backbone of any package. The NRECA package is of absolutely no use to consumers who do not reside in one of the NRECA areas for NRECA has been prevented from selling outside these areas. After over a year, NRECA has about four hundred subscribers many of which can reasonably be expected to be NRECA member companies and their officials rather than consumers.

Other "Packaging" Efforts

We have seen during the last year several home satellite earth station equipment

manufacturers such as Houston Tracker and Echosphere attempt to work with satellite programmers to provide a "free," one-year subscription to the Discount Satellite Service package controlled by Turner Broadcasting. It was intended as a limited trial period which was to expire June 30th. This "solution" was, at best, incomplete. It applied only to certain manufacturers and it was for a limited duration and did not involve a third-party (independent-of-cable) entity purchasing programming at wholesale rates and selling at retail. In any case, even this limited effort has expired with the control being exerted over Turner Broadcasting by TCI and the other MSOs as a result of their acquisition of the company. Simultaneously with that purchase, Turner Broadcasting withdrew from the packaging business. This is not a coincidence.

It is painfully obvious to those in the home satellite earth station industry, as well as to knowledgeable consumers, that there are no independent-of-cable, third-party packagers because the major cable operators want it that way. Programmers are understandably reluctant to admit in public what they say in private. And that is, that when the major MSOs squeeze, they cry uncle. To remedy this situation, we urge the Congress to pass S. 889 which encourages the start of an independent-of-cable pipeline to the earth station consumer.

The growth of cable television is reaching a plateau. The growth of pay and basic services has not been substantial over the recent past. Showtime alone, experienced a net loss of about 400,000 subscribers in 1986. Therefore, the non-aggressive stand of the satellite programmers towards the satellite earth station consumer is against their economic self-interest and appears to be motivated by some fear of expanding their business opportunities. Most programmers will not say in public that they fear retaliation by the large MSOs. But their fear is obvious in their behavior.

Last year these issues were bought to the Senate and legislation failed to pass by some six votes. Home satellite consumers were told it was too soon for legislation. Now

we are bringing them back to the Senate and saying that unless legislation passes, and passes very shortly, we fear it will be too late for the consumer who will be denied a fair choice.

Hardware Issues

The disaster in the marketplace may also be seen by an examination of the pricing and distribution practices associated with the VideoCipher II. Since the introduction of scrambling, there have been constant questions concerning the availability of decoders. Up until very recently, General Instruments, as well as the FCC, denied there was a shortage. But today there is a critical shortage as recognized by everyone in the industry, including General Instruments. By creating additional confusion in the marketplace this shortage is harming the consumer and driving the small dealer and distributor out of business. General Instruments has promised that the shortage will be cured by this fall. If it is not cured immediately, there is little question who will be around to pick up the pieces. It will be the cable television MSOs. As a result, the consumer will be denied alternative sources of programming.

There are several reasons for this shortage. The first is that General Instruments has, for all intents and purposes, a monopoly over the development of hardware and, unthreatened by competition, responds at its own pace to what it, and it alone, perceives to be the demands of the marketplace. The second is that the growing black market in chips has ironically resulted in increased demand for the VideoCipher II. General Instruments has now admitted that there are "over 30,000 pirate videociphers." Satellite Times, June 5, 1987, page 14. Most industry observers believe this is a substantial underestimate. Up to 100,000 may be on the black market. Daily we hear of new reports that the technology has been compromised.

The developer of this technology was widely quoted as assuring the public that it would not be compromised when it was introduced. Yet it has. Now General Instruments

assures us that it is doing everything it can to cure the leaks. It has filed a few lawsuits and has taken electronic countermeasures designed to turn off illegal subscribers. It is unclear how successful these have been. It is clear that in attempting to turn off illegal decoders, General Instruments has also turned off legitimate subscribers and damaged their reputation as well as the reputation of the satellite dealer that sold them their equipment.

The primary methods which have been used to defeat the scrambling system have involved modifications to the scrambling chip. A would-be pirate purchases a black-market chip and inserts it in a VideoCipher II decoder. Thus, for every illegal chip, General Instruments sells a VideoCipher II. It is for this reason that some have claimed that the only people benefitting from piracy today are the pirates and General Instruments.

Again, this is a symptom of a bigger problem. Had General Instruments licensed the technology at reasonable fees to other manufacturers, and if programming was easily available in packages at reasonable rates, it is likely that many of these problems would not have occurred. General Instruments, isolated from a competitive threat unlike the developers of the VHS videotape standard, did not make its technology available to others in such a manner as to bring about competition. Instead, it imposed a million dollar licensing fee and sell back, and other restrictions and we now have a shortage of devices, an escalation in their price and a virtually uncontrollable piracy problem. Nor are these the ony problems with the VideoCipher II.

The VideoCipher II Does Not Prevent Theft of Service

Motion picture studies have made it clear to the cable television operators and to the pay television networks that the theft of service with respect to feature films is intolerable. The overwhelming majority of this theft of service, however, is along cable television lines. There has also been some theft of service by some SMATVs that take

the service without paying for it. But the billion dollar a year problem of theft of service along the cable lines, which is estimated by the Coalition Agency Signal Theft, the industry's own organization, to be some five million illegal "subscribers," is not going to be cured by scrambling of programming on the satellite by the means which is currently being implemented. This is because the decoding occurs at the cable television headend. It is after the cable headend that the theft of service occurs. What is needed for effective theft of service protection at low cost is a universal system that will allow for every television set in America to receive scrambled signals on a uniform basis. With a decoder associated with every television set, theft of service would be virtually eliminated.

The benefits of a universal decoding system would also inure to the consumer who, over the long run, would pay less for decoding systems because of the large number of them that would be produced. With universal decoding, consumers should also pay less for programming in the long run because of the absence of theft of service. That is, there will be greater revenues to the cable industry, the program distributors and producers, thus containing the pressure for rate increases.

The VideoCipher II decoder does not work in a manner that would allow for individual decoding in the home of a cable television subscriber. The largest cable operators want it that way, otherwise there will be too much power in the hands of the satellite television networks. It is argued that cable would merely deliver the signal down the line to the cable subscriber who would in turn become a customer of the programmer.

Again, the benefits of scrambling to every cable customer would be that instead of a relatively small number of decoders to serve the present two million earth stations,

there would be an immediate market for some 35-40 million decoders. This would certainly bring the price down to a reasonable level and again, it will eliminate the real theft of service problem.

Stand-Alone Decoders

Until recently, stand-alone decoders were sold to distributors by General Instruments at $325 and were sold at retail at $395. This left a potential margin for two levels of distribution, i.e., distributors and retailers, of $70 or 17.8% margin. Typically, in consumer electronics, two tiers of distribution would have approximately a 40% margin factor. This is not to argue for higher decoder prices for consumers, but to demonstrate General Instrument's monopoly power to force a product through to market without providing adequate incentives to the distribution chain to market the product. Dealer margins have recently been further reduced by the serious shortages encountered because distributors have raised prices, and dealers are loath to charge higher than the $395 price which they already consider much too high. In contrast to the limited potential profits for dealers, General Instruments has an "electrifying profit margin . . . . It costs about $200.00 to manufacture, including overhead and marketing, and sells as fast as General Instruments can produce it for $325." Forbes, June 29, 1987, page 39.

At least two manufacturers have asked to purchase the $150.00 module to build a stand-alone decoder. The answer was no. In both cases, the manufacturer also tried to work out a satisfactory plan for manufacturing stand-alone decoders for their own use. It was insisted that any "stand-alone" decoder would have to be permanently attached to the receiver and be compatible only with that manufacturer's receiver. In other words, neither General Instruments nor its predecessor allows other manufacturers to build stand-alone decoders.

The sale of stand-alone decoders is likely to last for a considerable length of time. There are already nearly 2 million receivers in the market. The minimum lifespan of most of these receivers is five years and many will last twice as long. Additionally, all receivers currently being shipped in the marketplace are not integrated receiver/decoders. Not all receiver manufacturers have, in fact, been able to sign license agreements to incorporate the VideoCipher II module in an integrated receiver/decoder. If indeed, the transformation takes place in which the vast majority of decoders are integrated receiver/decoders, it is estimated that this will occur over a number of years. Thus, under present circumstances, only a slow transition can be expected. This will have the effect of retarding the availability of lower-cost decoding.

Integrated Receiver/Decoders (IRDs)

An integrated receiver/decoder should not only save shelf space for consumers, but provide the decoding function more economically. The VideoCipher II module is approximately 11" x 9" x 2". It does not appear to fit the configuration of any receiver being manufactured in the marketplace. Therefore, all receiver manufacturers wishing to incorporate the module must reconfigure their designs to General Instruments' specifications.

It has been suggested that the module should add only a $160-$175 cost to the receivers. This provides only $25 to the receiver manufacturer for research, design, retooling and profit. In other words, General Instruments is forcing other receiver manufactuers that incorporate the module to do so at virtually no profit. This does little to incentivize manufacturers other than, again, through the forced "take it or leave it" effect of monopoly power.

A further example of monopoly control is that General Instruments does not allow manufacturers to design their receivers to merely accept the modules and allow the modules to be distributed in the marketplace through normal distribution, that is, through

distributors and retailers. General Instruments is forcing the manufacturers to place the module into the receiver themselves. What this means is that General Instruments is forcing every manufacturer that wants to have an integrated receiver/decoder, to become a stocking distributor for the General Instruments modules. This is a further deterent to lower prices.

Second Sources

It has been argued tha second sourcing will prevent General Instruments from being a monopolist. However, in order to manufacture the VideoCipher II module, General Instruments demands a license fee of one million dollars. Out of the more than a dozen receiver manufacturers, only one has found this entrance price acceptable. That company, Channel Master, a division of Avnet, is a New York stock exchange company and the largest antenna company in the country. The rest of the satellite television receiver manufacturing industry cannot pay such a license fee. For all intents and purposes, the ability to produce a module at a lower price than General Instruments and compete with it in the marketplace, rests with one company, Channel Master. But, it appears that the licensing agreement has restricted the ability of licensees to sell modules to receiver manufacturers in competition to General Instruments.

General Instruments is a receiver manufacturer in competition with all other receiver manufacturers. General Instruments has introduced its own integrated receiver/decoder into the marketplace. Since General Instruments controls the decoding technology, it is at a distinct advantage over every other receiver manufacturer in producing the IRD. If it wants to, it can essentially eliminate all profits in the decoder area and produce an IRD that will be priced much lower than competiting IRDs. And it has the ability to raise and lower its prices in a manner not achievable by any other receiver manufacturer. Properly manipulated, General Instruments can become the

dominant and even the exclusive receiver manufacturer through such price manipulation. It is for these reasons that the June 29th issue of Forbes magazine states:

> "... there aren't many market monopolies or near-monopolies left these days. And for a couple of years at least, the General [General Instruments] seems to be holding some fairly secure high ground." Page 39.

We would urge a prompt and real evaluation of these issues by the FCC and FTC. Among other related issues to be examined we would include:

> The number of modules for integrated receiver/decoders which General Instruments allocates for itself.
>
> The reasonableness of the certification process which General Instruments puts potential IRD licensees through.
>
> The reasonableness of the requests for information made by General Instruments of its competitors in the certification process.
>
> The pricing practices of General Instruments and why the cost of the VideoCipher II has not come down.
>
> The reasonableness of the terms and conditions which General Instruments imposes for use of its Authorization Center.
>
> The adequacy of the VideoCipher II's current system capacity and its plans to increase that capacity.
>
> The ability and inability of manufacturers without IRDs to source stand-alone decoders.
>
> The unwillingness of General Instruments to supply manufacturers with stand-alone decoders.
>
> The continued problems posed by terrestrial interference to many consumers who own VideoCipher IIs.

We have seen how the marketplace has developed over the past year and a half. It has been a disaster for the consumer. Intervention in this matter is more than warranted. This is achievable in a variety of ways. Legislation should be passed requiring the FCC to oversee the development of a standard to which many manufacturers could build the decoders. Reasonable and fair licensing provisions should be made which would enable others to obtain licenses from General Instruments to build

modules. Provisions requiring that these decoders be sold back to General Instruments should be eliminated. Others should be allowed to make stand-alone decoders. Consideration should be given to requiring General Instruments to license its patents.

For these reasons, HSTA supports those provisions of S. 889 including those which provide for a governmental role in overseeing the development of scrambling technology. We recognize the real concerns associated with the government mandating standards. Government involvement in this field, however, poses a theoretical risk, a risk which in light of the circumstances is tolerable. No governmental involvement in this field provides with complete assurance that the problems already encountered will be multiplied and the emerging de facto standard will not serve the consumer's interest.

Conclusion

Consumers and retailers of home satellite equipment have their backs to the wall. The marketplace is not developing in the interest of anyone except the nation's largest multiple system cable television operators. As a result, the consumer is denied the choice which taxpayer-supported technology has provided, prices are inflated and shortages have developed. Piracy is widespread and has not been stopped.

For the above reasons, we strongly urge Congress to pass S. 889 to enable the marketplace to function fairly.

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QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

1. Has Congress ever passed a statute that guarantees the people the right to receive or become the distributor of programming similar to HBO, Showtime, ESPN or traditional television-type programming?

Answer

There are several precedents for the type of action which we are requesting. The closest precedent is the cable compulsory license passed by Congress in the 1976 Copyright Act. At that time, cable was a small industry which did not have the economic muscle to purchase programming from its competitors in the broadcasting industry. As a result, a compulsory license was passed ensuring cable subscribers continued access to broadcast stations. The legislation included a formula which established the rate to be paid.

S. 889 is far less intrusive from a regulatory stand point. First, it does not mandate that programmers must deal with others. It says instead, that if they do sell through any distributors, they must do so without discrimination. Secondly, it does not mandate what rates should be set the way the cable compulsory license does. Instead it merely attempts to ensure that similar parties will be treated similarly.

Another precedent for the type of action requested may be found in the cable television pole attachment legislation. There consumers are guaranteed continued access to cable programming by a requirement imposed upon telephone and utility companies to make their facilities available at rates set by a formula which is included in the legislation. Once again S. 889 is far less intrusive than is the pole attachment legislation.

2. Should S. 889 be expanded to require programmers to remain on C-Band satellites?

Answer

HSTA does not believe it is wise to expand the legislation to mandate the continued use of C-Band satellites. We believe the legislation should be frequency neutral. Should some of the programming services in the course of their natural evolution migrate to K-Band or Ku-Band, the legislation's requirements would still apply.

3. Do you believe that a programmer could survive by just airing programs for dish users?

Answer

Until the nucleus of dish owners is large enough to support full time programming service directed only to dish owners, it is unlikely that a full service programmer could survive by just airing programs for home satellite antenna owners. There have been numerous and unsuccessful attempts to provide this type of service. It should be noted that the cable industry for the first quarter century of its development survived by providing its subscribers only with broadcast television signals. It was only much later in that industry's evolution that the cable television subscriber base became large enough to support independently created or packaged programming. We believe the same will happen in the home earth station area, only much sooner.

4. There are some 70 unscrambled signals in service. In light of this, why is it so important that dish owners have access to scrambled programming?

Answer

Consumers purchase satellite antennas because of the variety of programming services provided. By far the most popular programming services including WTBS, WOR, WGN, CNN, CNN Headline News, ESPN, HBO, Showtime, Disney, Cinemax and The Movie Channel are now, or will be very shortly, scrambled. Others will likely follow. For home dishes to be viable, it is important for dish owners to have access to these popular scrambled services. Ensuring access to these programming services will enable the home satellite television industry to act as a real competitor to the newly deregulated cable television industry. This will act as a marketplace check on the rates consumers must pay.

Finally, it appears that of the seventy signals which may now be available, many are scheduled irregularly, others are duplicative feeds and still others have said they will soon scramble.

5. There are many programming services delivered via satellite that are not used by cable operators. Should these services be brought within the scope of S. 889?

Answer

S. 889 today covers primarily services delivered to consumers and controlled by major cable operators. It also includes provisions governing PBS, AFRTS and network signals. These are the primary areas of concern for home dish owners. In each case, there is a record of eitner actual or threatened refusals to deal or tax dollar support. We see no reason to expand the legislation beyond these provisions at this time without evidence of, or incentive for, service denial.

6. Some cable programming comes via microwave systems. Should the public have access to such programming?

Answer

Satellite communications, which was developed in part at taxpayers' expense, provides a unique opportunity for all Americans to view programming services at rates which are distance insensitive. It provides the unique opportunity for rural and other signal starved Americans to be treated as first class citizens. These benefits are not as clear in the case of point-to-point microwave systems. Also, the technological nature of point-to-point microwave is not that of a public transmission system in the same way that a satellite communication system is. Satellite communications can already be viewed across the country. We see no need at this time for the legislation to be expanded to cover programming services delivered via terrestial point-to-point microwave systems.

7. Since you believe the actions of the programmers have been anti-competitive, why haven't you brought an antitrust suit?

Answer

While there certainly are elements of anti-competitive behavior, we believe there are also strong elements of communications policy involving, among other things, access to maximum communications at reasonable rates for all Americans. An antitrust suit is extremely expensive. It is not uncommon for such cases to drag on for a decade or more. This industry has been decimated in the last 18 months and may not have the resources to wage a protracted antitrust battle against such well financed conglomerates. Congress has the authority to resolve these issues this year through passage of legislation.

8. Will the reinstatement of syndicated exclusivity rules by the FCC have any effect on home dish users?

Answer

The reimposition of the syndicated exclusivity rules will have a major negative impact on carriage by cable television systems of the superstations. Major portions of their programming will have to be deleted if the Commission imposes syndicated exclusivity rules such as those which were previously in existence. As a result, it is probable that carriage of the superstations will be dropped from many major and medium market cable systems. It is not all clear whether the still existing universe of cable systems as well as home dish viewers will be sufficient to permit the carriage of these superstations on the satellite. Should they go off the satellite, this will of course negatively impact dish owners. It is for these reasons that HSTA has opposed the reimposition of syndicated exclusivity rules.

9. Should S. 889 be expanded to ensure that SMATV and MMDS operators also have access to scrambled programming at reasonable rates.

Answer

Home satellite owners have been on the direct firing line of this battle for the past four years. The extent of this problem and the length of the problem have been well documented in Congress in hearings each year over this period of time.

It is HSTA's understanding that SMATV and MMDS do have some significant problems in obtaining access to programming services. We believe these problems are worthy of Congressional and Senate scrutiny. Such action must not, however, slow down passage of S. 889 in any way. Passage of this legislation, as is at this time, would give a clear signal to program suppliers that if they do not deal fairly with MMDS and private cable, Congress will not be reluctant to step in.

Senator GORE. Thank you very much. We appreciate your testimony.

Our next witness is Mr. Robert Thomson, vice president with TCI, a multi-system cable operator. Mr. Thomson.

STATEMENT OF ROBERT THOMSON, VICE PRESIDENT, TCI, WELLSHIRE STATION

Mr. THOMSON. Thank you, Mr. Chairman. I am happy to appear here today to explain in somewhat more detail what Tele-Communications Inc. is doing to aggressively serve the home dish market.

Our company is a multi-system operator. We are headquartered in Denver, Colorado, and we do have a program of aggressively serving this market.

The first of its features that I would like to discuss is our packaging for home dish owners. We were the first multi-system operator to package a series of programs for home dish owners. We have aggressively marketed that package. We have three times reduced its price in response to competition from the programmers themselves and from other packagers.

And we have done our best to get the word out through advertising to the home dish community that the package is available.

We are somewhat pleased with the sales. We wish the numbers were higher. We perceive several problems which have hurt our sales and we presume have also hurt the development, the orderly development, of this market elsewhere.

The first of those problems is delay in scrambling by the major programmers. Only seven of the 21 programmers we offer are scrambled.

The second is equipment shortages, which will be discussed at length later.

The third is trying to deal with the economies of scale and the transaction costs for ordering up home dish programming, and we have got some ideas on how that problem can be tackled.

A fourth problem we have had is restrictions on our use of the DBS authorization center in La Jolla, California, by the programmers. We have been arguing with the programmers for a year on this issue, and we hope to resolve it very shortly.

And the fifth issue, another issue which we have pounded on the programmers repeatedly about with absolutely no success, are the area restrictions which are imposed on us marketing our programs.

A second major area in which we have been active in serving this market has to do with Netlink. You will have a representative from NBC here later today to discuss what Netlink does and how it is intended to provide network programming to white area dishes.

We are proud of our involvement in it, but I am not going to discuss it in any more detail right now because I think your specific questions will more reveal where the confusions lie about the service.

Let me make one final point that needs to be made by our company and by the cable industry in general. Through the years, particularly in the last ten to twelve years, our industry has spent billions of dollars for programming, for transponders, for uplink facilities, for encoders, for back room operations, and we have done so willingly to serve our cable subscribers.

Now the benefits of those investments flow to the home dish industry in a very special way. The facilities and the investments act to reduce substantially the cost at which programming can be provided to the home dish industry. It is a marginal cost, rather than a developmental cost.

I emphasize to you that we think that is as it should be. These investments were derived from cable operations which by the main over the last several years have been conducted in a less hostile environment than we had to experience at the beginning of our industry.

That less hostile environment has been created in part by laws that you and your predecessors have passed. We believe that those laws were passed because you saw that cable was a device for serving the underserved in our country and bringing television to the small rural communities. We have done that.

The easy job is done. There still remain two, three, four million, who knows how many, residents that cannot economically be reached by cable in the rural areas. And the question now for our industry is, should we turn our back on these people, should we leave their screens blank, simply because our existing delivery mechanism is not suitable? We do not think so.

TCI is one company that thinks we have made a commitment to serve the underserved areas, and we intend to market a package and do all we can to see that they get the television the rest of us take for granted. That is the theory and the philosophy that has governed our policies, and I would be happy to answer questions on how we have implemented those policies later in the day.

Thank you.

[The statement follows:]

STATEMENT OF ROBERT THOMSON

VICE PRESIDENT, TELE-COMMUNICATIONS, INC.

Thank you for the opportunity to testify on S. 889 and to offer some observations based on the experiences of Tele-Communications, Inc. ("TCI") serving the home satellite dish market. My name is Robert Thomson and I am Vice President of Government Affairs for TCI. Although I have the staff responsibilities that my title implies, I also have line responsibilities in the areas of interest to you today. The person who coordinates our company's home satellite dish efforts reports to me and I am TCI's representative to the Netlink partnership. As I will discuss later, Netlink has a program for distributing network affiliate programming to home satellite dish owners who are otherwise unable to receive it.

TCI got its start by bringing affordable television service to small, rural communities throughout the West and Southwest whose residents were unable to receive adequate broadcast signals off-air. In 1968, when Bob Magness, our Chairman, founded Tele-Communications, Inc., it consisted of 35 cable systems of an average size of 1400 subscribers. In 1973, when John Malone came to TCI as President, the company had grown to 500,000 subscribers, with all but a few still in small farming communities throughout the United States.

Today TCI, as the largest multiple system operator with approximately 3.2 million subscribers in systems managed and wholly owned, is active in several of our nation's largest cities. Nevertheless, the company retains its distinctive rural character. Of approximately 2,100 franchises served as of June, 1987, over 95 percent are in cities or towns with less than 50,000 total population. The average size of the communities served by our systems is 2500 households. Finally, of the thirteen senior managers who work out of our modest corporate headquarters in Denver, nine of us were raised in rural towns of less than 10,000 people.

Like any business that seeks to deliver products and services to a predominantly rural customer base at affordable rates, TCI has had to capitalize on the latest technologies and develop an increasing business sophistication in dealing with the established suppliers of product, which in our case is television programming. We ourselves developed or encouraged the development of some of the latest equipment for operating and administering an efficient community cable system, and we were

quick to take advantage of satellite delivery as a means of transmitting television programming. More than that, however, TCI has been admittedly hard-nosed with the programming suppliers whose prices directly affect the rates which our dish owner and cable customers have to pay to receive quality television programming. Our policy of passing the resulting savings on to our consumers has been a successful one. We project our revenue per subscriber figures will be below $20.00 by the end of 1987, compared to an industry average of $22.00.

Given TCI's business philosophy of serving underserved markets and its rural upbringing, the company has an intense interest in serving rural dish owners who cannot economically be reached by cable. We believe they ought to be provided at affordable rates the full range of television programming urban residents take for granted and, just as important, TCI believes there are business opportunities in doing so. Before addressing the pending legislation, I would like to talk briefly about what TCI is doing to help develop that business.

TCI was the first cable operator to begin selling a package of programming to the home satellite dish market. Our first sales were in April of 1986, three months after Home Box Office and Cinemax started scrambling.

We offer two packages of programming. The Pay Package includes 16 basic programming services with any two pay services the customers may choose from a list consisting of HBO, Cinemax, Showtime, The Movie Channel and the Disney Channel. The Pay Package is priced at $17.50 per month plus $1.00 per scrambled basic service to a maximum of $23.50 per month. Comparable service to our cable customers would average over $30.00 per month. Each additional pay service costs $6.50 a month compared to an average cable subscriber cost of over $9.00.

The Basic Package we offer includes the basic services. That package is priced at $6.00 per month plus $1.00 per scrambled basic service to a maximum of $12.00 per month. Our cable subscribers pay about $14.00 a month for a comparable package. Currently, with two basic channels scrambled, the Basic Package costs $8.00.

TCI also leases descramblers as an option. To lease a M/A-Com Videocipher 2100-E from us, the home dish owner pays a $99.00 non-refundable set-up charge, plus $6.00 per month for 36 months.

TCI has lowered its prices three times since it began marketing its two dish owner packages. We did so after testing the market and talking to dealers around the nation. We also have to meet growing competition from other program packagers active in our service areas.

TCI has encouraged its system managers to develop working relationships with local satellite equipment dealers whereby TCI gives to a dealer a $30.00 commission on all referred subscriptions. The dealer provides the hardware, and TCI provides its programming package.

To encourage this relationship, TCI actively participates in satellite equipment dealer's association meetings across the country, such as a recent one in Swanville, NM this year. The dealers present at that particular meeting represented six states. Local TCI personnel also attend regional dealer's meetings and work closely with local dealers.

Although we are somewhat pleased that we have several thousand dish owners as customers after only slightly over a year, we wish the numbers were higher. There are several problems which we believe have hurt our sales considerably.

The first is the delay in scrambling by program suppliers. Of the 21 program suppliers who have given TCI the right to distribute their product, seven have scrambled their service, two are scheduled to scramble in August and nine more have announced plans to scramble in 1988. Two have set no date for scrambling and C-Span has announced it does not intend to scramble at all.

The wide availability of free programming discourages potential packagers who want to make a business out of selling that programming. TCI has chosen to ignore those short term disincentives and to market agressively its dish owner services. We suspect others have not.

A second problem has been the widespread and well-publicized shortages of descrambling equipment. TCI has approximately 1,300 descramblers on backorder with M/A-Com, but we accept M/A-Com's assurances that by Fall the shortage problem will disappear. We all must keep in mind the difficulty in predicting supply and demand of descrambling equipment in this relatively new marketplace.

A third problem is to achieve economies of scale by centralizing the additional administrative burdens of serving a market, which by its nature is decentralized, without losing the local customer contact essential to this business. One possible solution we have explored with other cable companies is to establish a central facility for processing orders from dish owners. There are several complexities involved in such a plan, including the mechanics of creating appropriate pricing policies, the confusion that could result where two or more cable companies are competing in overlapping home dish areas, which is often the case, and the reluctance of programmers to allow us to authorize their programming for a dish owner directly through M/A-Com's DBS Authorization Center.

The latter problem is particularly acute, since our local system people who take orders from dish owners now must often call each of the separate programmers on their toll-free lines for each customer. If we were able to authorize a descrambler directly through the DBS Center, our costs could be less over time and the savings would be passed on to the consumer.

Direct authorization is a very sensitive subject for the programmers since they are concerned about security of their customer lists, the compensation they receive for their product and other technical matters. However, we hope something can be worked out.

A final problem we have had little success in working out to date is the reluctance of some programmers to allow us broader distribution rights for our packages. As matters now stand, we have three types of non-exclusive distribution contracts with our programmer suppliers. The first limits our sales only to those home dish owners living within our operating cable systems. The second allows us to sell throughout the same county in which we have an operating cable system. The third allows us to sell in the two previous areas as well as in unfranchised cable areas in counties adjacent to the county in which we operate a cable system. In each case, I emphasize again that our contracts are non-exclusive.

TCI's negotiations with the programmers on this point have been very tough. As some of the premium services have maintained from the beginning, they want to retail the product themselves, and we can understand why. Margins are thin in this business. On the one hand consumers only have so many disposable dollars to spend on home entertainment. On the other, these programmers are purchasing a product for resale primarily from a small group of Hollywood studios whose output is limited, perhaps suspiciously so, and who have never been known for generosity in pricing their product. The premium services are legitimately concerned that too many middlemen will price their product out of the consumers' range. TCI can understand their desire to select only those distributors that truly add value to their product.

TCI has made the case from the beginning that we do exactly that. We and other cable operators have localized marketing and customer service structures. Because of our local presence, we can audit the location of descramblers to assure they do not migrate to unauthorized locations. Our basic corporate mission has always been to provide quality television programming to underserved markets, of which this is a prime example.

Nevertheless, 61% of the calls that TCI received from home dish owners in the first 5 months of 1987 were from those we were unable to serve because they were not in our distribution areas. TCI believes that if it could serve adjacent counties under the third type of contract I have described above, much of this

problem would be solved without sacrificing the local presence necessary to function as a proper distributor.

Next, I would like to discuss a second step our company is taking to improve programming for rural dish owners. For many years, TCI has transported at great expense Denver broadcast stations to its cable systems in outlying communities throughout the Rocky Mountain region. Most of these rural communities are beyond the reach of any commercial broadcast stations. Almost none could receive PBS programming, which TCI considers vital. The thousands of route miles of microwave TCI utilizes is owned and operated by WTCI, a company which was spun off from TCI in 1984.

Late last year, TCI and WTCI agreed to terminate the microwave carriage of the Denver broadcast signals to cable systems in these communities and replace it with a scrambled satellite transmission. TCI believes it can provide a higher quality signal at a lower price over satellite. At the same time we also were actively considering service to the "white area" dish market nationwide at a price just high enough to recover our costs as a public service. The theory was that once the network signals were uplinked to serve cable headends, it would be feasible from an economic standpoint to provide the signal to home dish owners, as well, who could not receive local network affiliate programming.

As WTCI began exploring the availability of transponder space and costing out uplink and scrambling equipment, it became aware of a company called Netlink, based in Kirkland, Washington, that had already uplinked the Denver network affiliates, two independent stations and the PBS station, and already had transponder space. Netlink had been organized specifically to serve the dish market. It planned to do so without agreements from the networks based on its theory that the compulsory license provided authority to offer such services.

Given the unclear state of the copyright law governing service to dish owners, TCI was reluctant to base its "white area" dish program on such a reading of the compulsory license. Our purpose was to provide the network programming to dish owners needing it, not to involve ourselves in time-consuming litigation in which no one's interests were well-served.

Likewise, TCI had no intention of engaging the networks and their affiliates in a drawn-out court battle over the impact of the service on the exclusive contracts local affiliates have to serve their localities. The concept of "localism" has found its expression in numerous FCC regulations and laws passed by this body itself, so we believed the speedier and more fruitful course was to proceed by negotiation and compromise.

After much negotiation, TCI and WTCI agreed to provide substantial capital to Netlink, to become partners with Netlink's original owners, to become a customer of Netlink as to the relatively lucrative business of transporting the Denver signals to TCI's cable systems and to finance Netlink during the lengthy process of negotiating agreements with the networks, their affiliates and other copyright holders.

In June, Netlink reached a complex understanding with NBC regarding the provision of broadcast signals from its Denver affiliate KCNC-TV to home dish owners who cannot otherwise obtain NBC affiliate programming either off-air or by cable. We are very optimistic that a similar agreement can be reached with ABC and its affiliates very soon. We are in active negotiation with CBS and have notified Fox Broadcasting Network that we would like to negotiate a similar arrangement with them.

All of these negotiations have been exceedingly difficult and time consuming. In all cases, the network affiliates' concerns have been important to our discussions. A senior representative from NBC is here today to discuss the Netlink arrangements with you, but I would like to point out that the restriction in the NBC understanding against providing Netlink's programming to the comparatively few dish owners in cabled areas was a result of affiliate concerns about exclusivity of their programming in local areas of influence.

The affiliate concerns in this area were heightened because F.C.C. network non-duplication protections run against cable companies, not against dish owners who may reside in the protected zone of influence of a local affiliate. For that reason and others, the affiliates insist that where a residence can access local network signals off-air, by cable or by other means, distant network affiliate signals should not be provided to that residence by Netlink.

A third way we hope we have been helpful to the dish industry was our early efforts to push for a common encryption technology, an area addressed by S. 889. We realized at the outset that multiple technologies would impose additional equipment costs on cable operators and intolerable costs for home dish owners. Consequently, when HBO announced it had selected the Videocipher technology, we did what we could to push the concept of an industry standard based on HBO's decision.

The cable industry also ordered $60 million of Videocipher equipment for all of its headends shortly thereafter. We know that the initial investments by TCI and other cable companies in these Videocipher descramblers paid much of the "make ready" costs for the Videocipher technology, and ultimately reduced the costs for programmers to serve the home dish market.

In conclusion, I would like to turn to some comments on the legislation pending in the Committee. In the House hearing held a month ago, the debate over similar legislation pending in that body turned on assertions that the marketplace for packaged programming suitable for home dish owners was working and counter-assertions that it was not. TCI suspects that the marketplace is working as well as can be expected at this stage. However, TCI also expects that this is small consolation to members of the House and Senate who apparently are hearing from a number of dish owners and dealers who are impatient with the pace at which market is working.

I have already discussed why we feel the marketplace is not working fast enough to suit us, but one other reason deserves special mention.

There has been an unreasonable reluctance among some in the dish community and some programmers to see cable operators heavily involved in serving dish owners. This has been a serious misjudgment which we believe has deterred a number of cable operators from aggressively pursuing the business opportunities that may exist in serving this market. Cable operators that can integrate the mechanics of delivering home dish programming into their routine cable operations can offer such services cheaper than anyone else. Our sense is that open hostility from some in the dish community has been a particularly serious deterrent for many cable operators who otherwise might offer services in or adjacent to their franchise areas.

TCI does not believe S. 889 will speed up the development of this marketplace. If signed into law, it would represent such a startling intrusion of the federal government into a private marketplace, that it surely would spawn vigorous and lengthy court challenge. The third-party distribution section is open to several interpretations. Thus, its limits would just as surely be tested repeatedly in court by would-be distributors who fancy the opportunity to sell a product which costs them nothing to develop, which poses no inventory risks, which requires virtually no capital expenditures for delivery and whose advertising and brand identification have been furnished by others. TCI believes passage of the bill will stop development of this marketplace in its tracks for years to come.

However, TCI does support the sponsor's underlying rationale. All Americans benefit when rural Americans have access to the educational, news and entertainment programming transmitted by satellite. There is a good case that special efforts should be made to keep the cost of such services at an affordable level, and I have detailed some of the steps TCI has taken in that regard.

Our deepest objection to the bill is a philosophical one. Quite frankly, it is time for both the cable industry and the backyard dish industry to realize their fates are inextricably combined. Both have an interest in increasing the variety and quality of satellite programming available. Both should be concerned about F.C.C. proposals to black out major portions of superstation programming by reimposition of syndicated exclusivity or repeal of the compulsory license. Both should be vigilant regarding Hollywood's efforts to create market conditions by law that increase the cost of programming to home dish owners and cable subscribers alike. Both need to work closely with the programmers to liberalize restrictive marketing rules and program authorization procedures that make it harder for cable to serve the home dish market.

I regret to say that S. 989 will make it harder to foster that type of cooperation among our two industries. The bill by its terms invites litigation between us and would interject the federal government into a developing marketplace in an unprecedented way. Indirectly, it would pose a threat to cable business practices and proprietary dealings that are common to every other major industry in the United States.

The backyard dish business is, after all, only 1-1/2 years old. It effectively began when HBO-Cinemax scrambled just last year. TCI does not believe we should begin what we hope is a long and mutually rewarding business relationship on such a note as this.

Senator GORE. Thank you.

Just a passing comment. Last I checked, the taxpayers of this country had something to do with the development of satellite technology.

Mr. THOMSON. Absolutely no question, sir.

Senator GORE. And the comparison, I think, of our investments, the taxpayers, rural and urban alike, to those of the cable industry would be interesting to look at. I would imagine the latter would be a very, very tiny fraction of the former.

Our next witness is Mr. Phillips, Mr. B.R. Phillips III, chief executive officer of NRTC. We are delighted to have you, Mr. Phillips, and please proceed.

STATEMENT OF B.R. PHILLIPS III, CHIEF EXECUTIVE OFFICER, NRTC

Mr. PHILLIPS. Thank you very much, Mr. Chairman. My name is Bob Phillips and I am the chief executive officer of the National Rural Telecommunications Cooperative.

Last year Bob Bergland of NRECA testified before this subcommittee and described our plans to organize and operate a national program to provide home satellite dish programming and services to more than 30 million rural Americans who we estimate will never receive the benefits of cable.

I want to share that progress with you and the distance that we have yet to go. Our goal is to deliver satellite programming to rural consumers with a cooperative, nonprofit service orientation

at an affordable monthly cost that is truly comparable to cable subscription service.

We are pleased to report to you that we have been successful in developing a beginning program package called Rural Television. We have included in that package six scrambled stations, CNN and Headline News, and four superstation signals.

We have also negotiated for other services that are not yet scrambled, and we have two letters of intent to do business with us.

I am further pleased to report to you this morning that we have struck a deal with ESPN sports programming to offer their entertainment programming and the NFL package this season to rural America. We are also offering three network affiliate channels as an optional tier of service, and we will also be offering Request Television, a pay per view movie service.

Presently we are operating in a pilot stage, with some 800 subscribers on line, and we would hope to make our package broadly available by September. We are working to add additional basic services to our package and offer other premium movie services.

At this juncture, however, I would like to make it clear that certain programmers have no intention of selling their product through NRTC. Therefore, access to quality programming is a key issue in this marketplace. As an example, I would cite both HBO and Showtime, which have advised us that they will not license the sale of their programming to NRTC, as they do for cable companies. They have both ignored written offers from us for pre-buys of subscriptions of one million dollars each.

Furthermore, it is noteworthy that Showtime boastfully advised us last week that they have exclusive rights to distribute MTV and VH1 to the TVRO market and they are not available to us.

Pricing is another key issue. NRTC does plan to offer the same level of support as a cable system would provide to its consumers.

Mr. Chairman, you are right on the mark when you indicate that the true test of price in this market is at the wholesale level and not the retail. We see no reason to discriminate against a TVRO subscriber because he receives a signal via satellite rather than through a cable line. However, some of the contracts that we have entered exceed the cable wholesale price by as much as 500 to 700 percent and more.

We see absolutely no justification for this tremendous price differential.

We are also extremely concerned about the impact of certain restrictive terms and conditions which have been included in some of our contracts.

The scrambler availability issues are also a major consideration in the marketplace at this time. One company, General Instruments, controls the FCC-deemed de facto standard, and they also control the licensing, the manufacturing, the availability, the supply, and the use of the authorization center, which I point out is the key to developing the future technology and enhancements to it.

Mr. Chairman, we have had some success in entering this marketplace, but we would be the first to acknowledge that our struggle to obtain access to programming at fair prices, with fair terms and conditions, is far from finished. This market should be open to

NRTC, it should be open to others—packagers, programmers, and dealers.

Senator, we agree with you and your colleagues this morning that this marketplace is not working. If our experience is any guide, we can confidently state to you that this market will develop competitively only with Congressional intervention.

S. 889 is desperately needed, as well as a resolution to the copyright question that is affecting the delivery of superstations and network stations to the home dish owners.

I thank you for this opportunity and I will be pleased to answer questions.

[The statement and questions follow:]

STATEMENT
OF
BOB PHILLIPS
Chief Executive Officer
National Rural Telecommunications Cooperative

before the

Subcommittee on Communications

Committee on Commerce, Science & Transportation

United States Senate

July 31, 1987
Washington, D.C.

S. 889

Good morning, Mr. Chairman. My name is Bob Phillips. I am the Chief Executive Officer of the National Rural Telecommunications Cooperative (NRTC). The NRTC is the national telecommunications cooperative organized in August 1986 by the National Rural Electric Cooperative Association (NRECA) and the National Rural Utilities Cooperative Finance Corporation (CFC). The NRTC is based in Washington D.C. and currently has a membership of nearly 400 rural electric and rural telephone systems located in 46 states. It was organized to develop and foster the growth of satellite-based telecommunications services for rural utilities and their consumers. I also appear before you today representing NRECA.

Bob Bergland, the Executive Vice President and General Manager of NRECA, testified before this Subcommittee a year ago today concerning the activities of the NRTC. He advised Congress of our goal to develop satellite-based telecommunications services for rural Americans. Today I will share with you and the Subcommittee the progress that has been made and the distance we have yet to go.

The NRTC has two basic missions: To develop and implement a satellite-based telecommunications business network for all the rural utility members and to organize and operate a national program to support the membership's effort to provide satellite TVRO equipment and services. This second charge specifically includes the creation of a package of entertainment, educational and informational programming for distribution to the home dish owner in rural America.

In the mid-1930's, rural electric and rural telephone cooperatives were established so that rural Americans could join together and create for themselves, on a cooperative, not-for-profit basis, a delivery system to bring the benefits of new technology to the unserved areas. These rural utilities brought electricity and telephone service to farmers and rural dwellers unable to obtain basic services at any price, simply because of their remote location. The cooperative, self-help spirit and the service orientation of these rural cooperative utilities have served rural America well for over fifty years.

Today, there is a new technology which promises rural America more of the benefits of modern living. Technology which brings services that those in urban centers take for granted. Satellite-based telecommunications is a technology custom made for rural America. It is a technology that has created a delivery system where miles and density don't matter. Now, the rural dweller can have access to information, education and even entertainment from his own back yard dish. But, the home satellite dish is more than an enhancement to the quality of life in rural America. This is the information age where use of high technology and access to information will separate the winners and losers in the 21st century. This technology is essential because it will be a key link in providing educational opportunities, stimulating development and economic growth and fostering new jobs and opportunities.

The NRTC is striving to bring the benefits of this new technology to rural America. Through the rural electric and rural telephone cooperative infrastructure, affordable satellite telecommunications services can be delivered. My testimony today will focus on our efforts to bring the direct benefits of this technology into the rural consumers' home. I also want to highlight the potential of satellite networks as an integral component of providing rural electric and telephone service.

We now have a bi-directional data transmission hub in place which is under test operation in St. Peters, Missouri. This Ku-band system will serve as the communications backbone for the data processing needs of 105 rural electric cooperatives. NRTC will soon be making this network available to all of its utility system members for their data transmission needs. Pilot projects and initial applications will come on-line this year. These applications will include electronic bulletin boards, banking transactions, remote telemetry or meter reading, energy management and load control, and inventory and data processing communications. As this system grows we will expand its capability to include voice communications and then video for education and training purposes. We plan to tie all rural utility systems together with a reliable and economical satellite telecommunications business network.

NRTC Satellite TVRO Business Plan

Projections show that 30 million U.S. homes will never receive the benefits of cable television programming because the population density will not economically justify the extension of cable service. We know that approximately 75% of our cooperative consumers have no access to cable service now and will never have cable. It is these unserved rural Americans who live without the benefits of modern television programming that NRTC seeks to serve.

Our goal is to deliver satellite programming to these unserved consumers with a cooperative, non-profit service orientation at an affordable monthly cost which is truly comparable to cable subscription service.

NRTC envisions that many of its member cooperatives will serve as a "one-stop-shop" for rural consumers to obtain authorization for scrambled satellite video programming, equipment and service. Some member cooperatives may choose to team up with local dealers rather than install the equipment directly. Subscribers who presently have a satellite dish system would be able to obtain a VideoCipher 2100E descrambler on a lease/purchase plan for an attractive monthly fee and subscribe to programming which is authorized directly through the NRTC member cooperative. Complete satellite TVRO systems may also be available directly from the local cooperative or installed by a local dealer in cooperation with the NRTC member cooperative. NRTC members will also have the ability to provide reasonable financing for consumer equipment.

The Beginning of "Rural Television"

We are pleased to report that NRTC has been successful in developing what might appropriately be called a beginning package of programming services for TVRO customers. The **"Rural Television"** package which we announced in May is a starting point from which to build.

The programming offered in our "basic package" which is now scrambled includes:

CNN
Headline News
WGN-TV - Chicago
WWOR-TV - New York
WPIX-TV - New York
KTVT-TV - Dallas

We have a signed contract with Turner Broadcasting Systems, Inc. and United Video, Inc., a common carrier, which uplinks the superstation signals.

In addition to the scrambled programming presently included in our basic package, we have also negotiated for services which have not yet scrambled their signals but plan to in the future.

The Nostalgia Channel -- Executed contract, anticipated scrambling schedule - Fall 1987.

The Learning Channel -- Executed contract.

We have negotiated the rights to include other services in our basic package which have not yet made or announced current plans to scramble.

Country Music Television.....Executed contract

Hit Video USA.....Executed contract

Home Sports Entertainment Ltd....Executed contract

NRTC has also executed a contract to include and promote The Travel Channel in the basic package. The service has no plans to scramble.

The Nashville Network has given NRTC written letters of commitment that they will participate in NRTC's package, and at this time we are awaiting a contract for execution.

We also received a written letter of commitment to participate in the package from the Christian Broadcast News Network and a draft contract which we are now reviewing.

The NRTC "**Rural Television**" package also includes an optional tier of programming consisting of three network affiliate channels. A signed contract with Satellite Broadcast Networks, Inc. is in place to provide:

WABC-TV - New York (ABC)

WBBM-TV - Chicago (CBS)

WXIA-TV - Atlanta (NBC)

A pay-per-view premium movie service will also be offered in conjunction with the NRTC package. Request Television has confirmed their participation with NRTC and we are presently negotiating the final contract.

At the present time, the "Rural Television" basic programming and the optional network tiers are being offered on a pilot basis by 5 rural member cooperatives of NRTC. These five cooperatives have authorized over 750 subscribers.

We are currently bringing additional systems on line in order to make the package broadly available by September.

Pricing

As a wholesale distributor, NRTC will not be setting retail prices for the programming offered through its cooperative members. However, NRTC is suggesting a retail price for the present basic package of $5.95. That price will increase as additional scrambled programming is included in the package. It remains our goal to deliver an attractive basic package for $10.00 per month or less. The present basic package plus the optional tier is now available for delivery through our members at a suggested retail price of $9.95 per month. The pay-per-view services will be priced individually on a per event basis.

Service

NRTC has contracted to obtain access to a nationwide communications network, and a computerized billing and data collection service which will be available to each NRTC member for authorization of programming. The local NRTC member cooperative will directly enter a consumer's order for programming selections on a computer terminal electronically linked with the DBS Authorization Center in La Jolla, California, which controls the scrambling and descrambling functions. The order is instantly placed, the billing data is captured in the system and the programming can be instantaneously authorized for viewing through the consumers' descrambler. The member cooperative will then render a monthly billing to the subscriber and service the account.

NRTC'S Experience in the Marketplace

NRTC has worked diligently for more than twelve months to assemble a well rounded and attractive package of programming with a seasoned industry consultant leading the negotiations and steering the packaging efforts. At this juncture, however, it is clear to us that certain programmers have no intention of licensing NRTC to offer their services.

Two premier movie sources, HBO/Cinemax and Showtime/The Movie Channel, have expressed no interest in offering their services to NRTC on a wholesale basis. Last year HBO had advised us verbally that they wish to pursue a direct marketing campaign and mentioned that they may be "at risk" selling to us because they felt their cable customers might become quite concerned.

HBO did indicate early on that we might offer their services on an annual subscription basis, acting as an agent who relinquishes all customer lists and data to them.

Recently, we made a written offer to pre-buy $1,000,000 worth of subscriptions at a negotiable price with NRTC acting as an agent. Under our proposal, however, NRTC would provide and maintain its subscriber base and HBO would be free to set the retail price only offering NRTC a discount. We did meet with HBO representatives last week to discuss the proposal, but HBO is not willing to license the sale of their premium movie services to NRTC as they do for cable systems.

We have had several discussions with Viacom International, owners of Showtime, The Movie Channel, Viewers Choice, MTV, VH-I, and part owners of Nickelodeon and Lifetime. Viacom advised that they would seriously consider a proposal for NRTC to offer their Showtime/the Movie Channel service that would provide a "specific and significant financial guarantee...as well as match our expectation of significant retail revenues." Despite our repeated requests, they did not respond to our written offer of $1,000,000 for advance subscription purchases at a negotiable price, with NRTC taking responsibility for all marketing, authorizations, billing and servicing of customer accounts.

Following the House Subcommittee hearings, Viacom did meet with us, but only reaffirmed their position of selling their premium movie services and package through cable affiliates or direct to the market. Like HBO, Showtime/The Movie Channel will allow NRTC to take subscriptions, but not to act as a wholesale packager. We also learned that Viacom has given an exclusive marketing arrangement to Showtime for both VH-1 and MTV, thus precluding NRTC and others from selling these services in competing packages.

There are other programmers who offer services which are extremely desirable to the rural subscriber. We believe ESPN sports programming is also an essential element of a well rounded basic service offering. This is especially true in view of their addition of the NFL programming this season following the scrambling of their signal which began last week.

ESPN has taken a "cable friendly" approach to the TVRO market first announcing its plans to sell locally through cable systems and through the national telemarketing operations of HBO and Showtime. Earlier this year, while negotiating a price increase to their cable affiliates to cover the NFL package, ESPN advised NRTC that they would offer their cable affiliates first choice at their own desired TVRO territory. They did promise to meet with us after July 1 to determine if there is sufficient territory remaining to be served and if they were inclined to sell through NRTC. We did meet last week and we are currently in

negotiations. NRTC is enthusiastic about the opportunity to bring the NFL to rural America and we are hopeful that our negotiations with ESPN will be successful.

Another very desirable premium service which is almost certain to be popular in the rural TVRO market is The Disney Channel. The Disney Channel has expressed an open willingness to work through the NRTC, and so stated before the House Subcommittee last year. However, earlier this Spring the Disney representatives expressed an interest in reaching the TVRO market direct, at least initially. We have pursued continued dialogue with them but Disney has made no commitment to NRTC beyond their testimony last year.

Netlink USA uplinks a package of broadcast network programming from the Denver area, a PBS station and a super-channel. In March, Netlink sent a representative to meet with us and then followed with a letter and proposed contract. We began discussions with them but just a short time later, when it was announced that Western Tele-Communications, Inc. (WTCI) was buying into them, they advised that they were not going to serve the TVRO market due to the uncertainty of the copyright issues. They persisted in advising us that they were not serving the TVRO market, despite public advertisements to the contrary. We made a written request to offer their network programming to our consumers, but have received no response. We now understand that TeleCommunications, Inc. (TCI) has reached an agreement to purchase 40 percent of Netlink and that Netlink has reached an agreement with National Broadcasting Co., Inc. (NBC) to serve dish owners in the "white areas."

NRTC has approached several other programmers whose service we would like to include in the basic package. Several have indicated they are still in the process of developing their policy on sales to the TVRO market, even though they are advertised in cable offered TVRO packages and/or the Showtime package.

One programmer which now offers its services to the TVRO market through cable distributors originally advised us that they would deny access to the TVRO market. They now tell us that they are developing a corporate policy concerning their distribution to the TVRO market.

NRTC's plan is to offer the same level of support as a cable system would provide its consumers. On this basis we would expect comparable rates for the same product. We see no reason to discriminate against the TVRO subscriber because he receives a signal via satellite rather than through a cable line. In fact, we should bear in mind that the TVRO subscriber must make a significant investment in a satellite dish system to receive the service plus the cost of the descrambler. The cable customers

monthly service charge includes both the delivery system and the programming.

Some programmers have argued that it is more costly to serve the TVRO market, but NRTC has come forward to purchase on the same wholesale basis as a cable company. We have set up our own "back office" and order processing service, direct authorization capability, a billing and collection system, and promotional programs. Despite this we have been unable to negotiate rates comparable to cable wholesale prices. In fact, some of the contracts we have entered into exceed the cable wholesale price by 500 to 700 percent or more! We see absolutely no justification for this tremendous price differential.

I have discussed with you today only one major problem NRTC has faced in negotiating agreements to provide programming packages for rural America -- the rate discrepancy. In order to obtain contracts, in some instances, we have also been required to accept restrictions in the marketplace we may serve and the administrative services we may provide. We are extremely concerned about the impact of these restrictions on our service to rural America and we continue our efforts to work through these difficult issues with the programmers.

Finally, we have great concern regarding several issues relating to encryption or scrambling. We have no first-hand knowledge but the conventional wisdom of general industry sources strongly suggests that there may be a serious security breach of the VideoCipher scrambling system. Since the VideoCipher has been labelled the "de-facto" standard by the FCC and the system has been adopted by all the major cable TVRO programmers to date, we feel the security issue bears further official review and oversight. Using the lease plan, NRTC members will be making a substantial investment in descramblers, there must be further assurance that the system will be secure.

It is a general knowledge that there is a descrambler availability problem. NRTC has ordered several thousand descrambler units with no firm assurance of delivery dates. Since descramblers are essential to providing our TVRO programming service we are extremely concerned about the present status and near term projections for availability.

Additionally and perhaps even more important, the absolute control of the technology which is maintained by one company is of great concern to us. General Instrument owns and controls the technology. It is essentially the sole descrambler manufacturer to date, and it makes all the rules which determine access to the DBS Authorization Center. NRTC is the first third-party packager to gain access to the DBS Authorization Center. And, from this experience we know that the terms controlling the availability and use of the Center are mandated, not negotiated. General

Instrument is also a full competitor in the marketplace with its own equipment line, a dealer network and a programming package which is offered with the purchase of their equipment. In our view this one company has an alarming degree of control over the development of this industry.

NRTC Position on S. 889

Mr. Chairman, I've outlined for you today the status of NRTC's package and the conditions that we have found in the satellite programming marketplace. It is for these reasons that the NRTC supports the enactment of S. 889, the Satellite Television Fair Marketing Act of 1987. We especially endorse the "third party packager" portions of the bill. While the NRTC has had success in securing contracts with some programmers, we feel that additional "leverage" is necessary in providing a full and complete programming package to our rural constituency. We have found that we need assistance in bringing everyone necessary to the negotiating table. S. 889 will provide this help. If a programmer makes a signal available through any other third-party, including a cable company then other entities should also have access to the programming on a non-discriminatory basis. Responsible third parties like NRTC, who want to provide an attractive "service" to consumers, must have access to popular programming. Further, the more that competition can be enhanced, the better it will serve the consumer. In this light there must be some measure of fairness in pricing and terms. The non-discriminatory standard required under the bill should be adequate to encourage a fair and competitive marketplace. Based on our experiences we believe this requirement could be equally as important as access to the programming.

Rural America knows well that deregulated environments do not help those with fewer competitive advantages. Sparsely-populated areas do not always share in the benefits of deregulation. It is the marketplace -- with as many competitors as possible -- that will best serve the consumers... all consumers be they urban or rural. It is for these reasons that the NRTC heartily endorses the concepts contained in S. 889.

Mr. Chairman, thank you for the opportunity to appear before you today and I will be pleased to answer any questions.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

Question #1: Do you believe that a programmer could survive by just airing programs for dish users?

Answer: At this time, I believe it would be a significant risk to launch a programming service exclusively for the home satellite dish market. There have been several program services fail attempting to provide programming to the cable market with its potential of 64.5 million homes. Given the present uncertainty in the home satellite dish market and the relatively small installed base of dishes (1.7 million) it would be extremely difficult to launch a satellite dish exclusive service while competing with the large and popular cable program services.

NRTC is interested in promoting a program channel focusing on rural issues such as agriculture, rural development, health, education and training. However, our research does not support feasibility at this time. The best chance for success in such a venture will come as the home satellite dish consumer base expands.

Question #2. There are some 70 unscrambled signals in service today. In light of this, why is it so important that dish owners have access to scrambled programming?

Answer: Currently, it is mostly the premier and popular services that are scrambling. Those scrambling include news services, superstations, sports programs, movie services and even the national networks.

Many of these services provide unique programming, such as national and international news, sporting events and movies which are not otherwise available on satellite or through any media for the rural viewer. As rural residents, NRTC subscribers should have access to advertiser supported network signals and all the other desired and premier programming that is available to urban and cable-wired dwellers.

With satellite technology, geography no longer restricts ones viewing options. There is no valid reason for any program service to deny access to the new audience of home satellite dish owners.

Question #3. There are many programming services delivered via satellite that are not used by cable operators. Should these services be brought within the scope of S. 889?

Answer: Programming services that are developed and aired for public and subscriber based viewing should be available regardless whether or not they are transmitted via cable. Only truly private transmissions should be exempted from S. 889.

Question #4. Since you believe the actions of the programmers have been anti-competitive, why haven't you brought an anti-trust suit?

Answer: NRTC's interest is in aiding the development of the home satellite dish market so that rural Americans are encouraged to use this exciting new technology. Bringing lengthy, involved and expensive anti-trust litigation against selected parties in the industry does not insure the success of NRTC's goal. NRTC has entered this marketplace in good faith and with the best intentions. We intend to pursue our efforts to become a third-party program provider rather than seek damage awards through embroiled litigation.

The enactment of S. 889 will address the marketplace deficiencies more directly, effectively and quickly than any lawsuit that can be lodged.

Question #5: Will the reinstatement of the syndicated exclusivity rules by the FCC have any affect on home dish users?

Answer: The reinstitution of syndicated exclusivity rules coupled with the expansion of the network non-duplication rules and the relaxation of the non-network territorial exclusivity rules, may exacerbate a programming supply problem already existing for rural Americans. Although the nation's urban areas may well have many alternative entertainment and video distribution systems available, including cable systems, UHF and VHF television stations, low-powered television stations, satellite master antennae TV systems, multi-point distribution services, video cassettes and theatrical distribution outlets, many of the nations rural areas are not so fortunate. In many of this nation's rural areas, the only viable link between viewers and these types of information and entertainment opportunities is the home satellite dish. Widespread exclusivity arrangements between broadcasters, program suppliers and cable companies could adversely effect the already limited supply of programming available in the nation's rural areas.

Senator EXON. I do not want to interrupt a lot. I have got a key question, I have got to leave, and I am afraid that Mr. Phillips will be gone. Can I ask one quick question, without objection?

Senator GORE. Surely, surely.

Senator EXON. Mr. Phillips, what kind of cooperation do you feel that the REA has had from the industry as a whole on this? Because it seems to me that, if we could work out something between the REA's, who have a record of great public service in rural areas, that it might go a long way to solve our problems.

What kind of cooperation would you say that you have had generally from the people supplying the services to an REA network of some type?

Mr. PHILLIPS. Senator, it has been very difficult. We came before you a year ago and announced our plans to try and enter this marketplace and develop a package, and we have struggled for a year now.

I have worked on this full time since March traveling around the country, trying to meet with programmers and arrange this package with the help of a professional consultant. The cooperation has been very limited in most cases, sir.

Senator GORE. Senator Exon, could I suggest that the staff put up the second chart? And here is a copy of it right here, and I think this will give you a graphic answer to your question.

On the left hand column is a list of the program services, and then you have NRTC, and they have gone and asked them to cooperate with them. The other two columns are the private enterprises that are in this market. And I think you can see from that chart that they have received a no from every single service except the two that have independent ownership or largely independent ownership, the Christian Broadcasting Network and CNN Headlines.

Senator EXON. Well, I do not want to divert any further. I mean, I just wanted to get that point early on in the record.

And this is one Senator that has been on this committee and on this subcommittee for a long, long time, and has tried desperately to work cooperatively together with everyone to solve the problem. I knew—I had not seen that chart, which is a very vivid one, Mr. Chairman. I am glad you pointed it up.

But I suspected that was the case, and I think the message should be delivered very loud and very clear by at least one Senator, and I suspect my views are shared by others to a considerable degree. The message should be very loud and clear that, despite the fact that there are a lot of people who are left out in America.

And I want to thank you, Mr. Phillips, for bringing out that part of your testimony. There are those of us here who are not going to forget those people, and you better get that message very loud and clear.

When I say "you" I mean all the rest of you.

Thank you very much, Mr. Chairman.

Senator GORE. Thank you very much.

Our next witness will be Mr. David Wolford, who is chief executive officer of the Home Satellite Services. And it is designated on that chart there I just referred to as HHS. But Mr. Wolford, thank you very much for joining us here today, and please proceed.

STATEMENT OF DAVID WOLFORD, CHIEF EXECUTIVE OFFICER, HOME SATELLITE SERVICES

Mr. WOLFORD. Thank you for the opportunity to testify.

I support S. 889. Working together, let us find solutions for the 16 million second class television constituents.

My credentials are: ownership and manufacturing of spaceborne components in the sixties; ownership and operation of rural Sun Valley cable systems in the 1970's; currently CEO of Satellite Orbit Magazine, with 1.4 million readers; and President of Home Satellite Services, a qualified third party programmer who has been unsuccessful to date in obtaining programming on fair and reasonable terms.

Let us examine our constituents' feelings for a minute. What are they? They are betrayed without representation in Washington, DC. They are feeling very, very lonely out there.

Is something wrong? You bet it is. When Jack Valenti yells foul, you know the scales must be really out of balance.

Programming. Where does HSS stand in their attempts? Let us just take a look. In January and February, we made professional presentations to all shown in column one. Column two shows who gave us formal replies.

Asked again in late July—we picked out the keystone programmers, and you see we got replies from all of them. Were there evasive answers? Column five, you bet there was. Okay.

Let me settle a myth right now that seems to be permeating this complete industry. Satellite programmers say to us—and in "us" I mean HSS, Amway, and NRECA—they say: All you want to do is collect the gravy and we do all the work.

That is wrong. Each of these companies, including my company, intend to provide full services, both marketing, distribution, protect the integrity of their programming services, and so on. And their only chore is to cash a single monthly check from HSS.

Have misrepresentations been made by programmers to the industry, to satellite viewers, to satellite consumers, and Congress? Yes. Packages including signals that are not scrambled, quoting low monthly prices to Congress that are really yearly fees paid in advance.

It is too bad that they do not want to give qualified third parties, such as Amway, HSS, and NRECA a try. They might be pleasantly surprised.

Let me take a second and touch upon a couple items relating to programming. A friend of mine owns a 1940 two inch TV set. It has got a little green screen. It still works, 47 years later. That is forward compatibility.

RCA and Dumont in the 1940's and in the 1950's licensed qualified manufacturers to use their patented television circuits. I wonder why they did this? To provide the widest possible distribution and sales, serve the public interest, and make a bigger profit, too.

This is democracy and free enterprise at its best. When asked by 1.4 million readers about forward compatibility, I have to say it does not exist with Videocipher II today.

It is time for the FCC and the industry, working together, to create such a standard, the same standard that allowed the 1940 TV set to work 47 yeas later. It is time to provide the home satellite consumer with that same forward compatibility.

Let me touch base on the FCC regarding the home satellite industry. Let them review their 1974 textbook, when they fielded a small cable task force. They went to the heartlands to find out what was going on, and what happened? Understanding by both sides, cable and the FCC, resulted. And the consumer was better served.

I am offering to set up and coordinate these regional field meetings. I invite you to take me up on my offer. Let me give you my business card. It is in your court now.

I want to touch base on the networks and white areas for a minute. During the last eight months, we have done substantial research on this area, and let me define adequate and inadequate.

Adequate signals to the home satellite areas of broadcast are excellent, good, fair. Inadequate are poor and none. We could not show all the states, so we picked out a representative group of states that would be relevant to this subcommittee.

So white areas must be served. The Netlink, 80 percent TCI-controlled, and the Denver NBC station, which is owned by NBC, deal stinks. I am told they only sell directly or through cable.

In addition, the network lawsuits against SBN are plain harassment, an attempt to prevent the public interest from being served. One wonders if it is now big cable and big broadcast putting on the boots together.

Let us remove the heavy hand of cable. Let us cut the cable connection. Let us fairly serve the 16 million underserved second class television citizens, without the heavy boots of cable and broadcast restricting their right to information and entertainment.

Mr. Chairman and members of the subcommittee, tomorrow is too late. Our, yours and mine, constituents desperately need your action to mark up and send Senate 889 to the floor for full consideration.

Thank you.

[The statement and questions follow:]

STATEMENT OF DAVID G. WOLFORD PRESIDENT, HOME SATELLITE SERVICES CEO, COMMTEK, INC.

Good morning, Mr. Chairman and distinguished members of the Subcommittee. Thank you for the opportunity to appear before you to present my views on the Satellite Television Fair Marketing Act.

My name is David Wolford. I am president of Home Satellite Services and I am attempting to market a package of scrambled satellite programming for satellite TV viewers. I am also CEO of CommTek, Inc. and publisher of *Satellite ORBIT* magazine. With over one million subscribers it is the leading programming guide for the industry.

Prior to founding CommTek, I was the owner of Wood River Valley Cablevision, the cable TV company for the Sun Valley region in Idaho. In all, I have had 17 years of experience serving the television needs of consumers, and I have been involved in satellite TV in one way or another since programmers began transmitting via satellite in 1975.

I am here to testify in support of S. 889. I will concentrate on the section of the bill that would require programmers to do business with any distributor who meets specific qualifications.

I agree with those who say that the best regulation is the least regulation. But I also believe that when a market is not working and the public interest is threatened, Congress has an obligation to step in and give it a friendly push. Because satellite programmers are operating what amounts to a monopoly, competitive pricing has not developed. As it stands, consumers are denied access to satellite television programming at fair and reasonable prices.

It is clear the situation will not be resolved in the marketplace. It is incumbent upon Congress to correct the inequities in the system. Your constituents, many of whom are dependent on satellite television for all of their educational and entertainment programming, deserve quality service.

SATELLITE TV PROGRAMMING MARKET IS NOT WORKING

In January of last year, Home Box Office began scrambling its two satellite TV channels, HBO and Cinemax. This began a difficult but necessary period of adjustment for everyone in the home satellite TV industry. I do not dispute the fact that program owners must protect themselves but the situation has become uncontrollable.

More than a year and half later the industry is at a virtual standstill. Consider these facts:

Significant numbers owners today are abandoning systems that are in good working order. Why? Because they feel they can no longer get the full value and enjoyment from their dishes under today's market conditions. Home satellite TV systems are selling at the rate of between 15,000 and 20,000 units per month. This level of new system sales is barely enough to maintain the current number of dish-owning households, which I estimate at 1.6 million. There is a natural attrition rate as systems that were sold four or five years ago wear out and are made obsolete by advances in the technology.

In the universe of 1.6 million dish-owning households, only a little more than eleven percent of dish owning households have purchased or leased a descrambler and subscribed to scrambled program services as of the middle of June. (According to figures supplied by General Instrument, owner of the VideoCipher II descrambling system.) When you consider that a descrambler is now required to receive any of more than two dozen leading satellite programming channels, 11 percent does not represent a very impressive market penetration.

The breakdown of this market has not been caused by scrambling per se. The price of the VideoCipher II descrambler, while a significant factor, is not the most important. The home satellite TV market is in trouble because a competitive market for programming has not emerged.

NO COMPETITIVE SOURCES OF PROGRAMMING

The reality is that today's consumer does not have competitive programming sources from which to choose. A dish owner who decides to purchase a descrambler and subscribe to programming services can choose from only two types of suppliers:

Programmers.—Home Box Office sells subscriptions to dish owners who call its 800-number. This is the case for Viacom's Satellite Networks Inc. as well. Turner Broadcasting Systems sells CNN and CNN Headline News to satellite TV viewers.

Cable companies.—In addition, dish owners can call local cable operators, or the national offices of cable multiple system operators like TeleCommunications Inc. (TCI). However, cable companies will only sell to dish owners who live in their franchise areas or in adjacent area.

Today, there are no other sources for scrambled programming. Because many dish owners do not live near a cable company, they are effectively limited to dealing directly with programmers. I do not believe that these two suppliers stimulate competition. Programmers like HBO and Viacom derive the vast majority of their revenue from cable operators. Are they really going to undercut the prices of their primary customers? I maintain the answer is no.

These two programming sources are inadequate for other reasons:

Common ownership.—Companies such as Time, Inc. and Viacom are rapidly moving toward complete vertical integration in the creation and delivery of programming services. Time, Inc. owns both Home Box Office and American Television and Communications, the second largest cable MSO. Viacom is the owner of five satellite TV program services (Showtime, The Movie Channel, MTV, VH-1, and Nickelodeon) and Viacom Cablevision, the eleventh largest MSO. TCI, the largest cable MSO has extensive interests in programming services.

The latest example of this rush to control programming creation and delivery was last month's virtual takeover of Turner Broadcasting by a group of cable companies led by TCI and Time, Inc.

Can we really expect programmers and cable companies that have common ownership to compete with each other?

Dealing directly with programmers is inconvenient. Satellite customers must contact each programming service individually in order to receive programming subscriptions. Furthermore, unlike cable owners who face a monthly charge, the satellite TV viewer must pay for these services on an annual basis.

Most cable companies do not sell to dish owners. A survey conducted last fall by the Committee for Programming Access indicated that only 21 percent of cable operators sell programming subscriptions to dish owners.

An overwhelming majority of dish owners do not have access to cable. A recent survey of Satellite ORBIT readers confirmed an earlier finding that only 22.3 percent of dish owners live within the service area of a cable company. A large majority of dish-owning households cannot purchase programming from cable operators. Therefore, they have only one source of supply—the programmers.

SURVEYS SHOW THAT CURRENT OPTIONS ARE INADEQUATE

What do satellite TV viewers think about the sources of programming subscriptions they have to choose from? Recent surveys we have conducted indicate that they are far from satisfied.

Dish owners want the convenience of ordering from a single source. In a January 1987 survey conducted by Opinion Research, 73 percent of the respondents said that it would be more convenient or significantly more convenient to order from one source. In a May 1987 survey of ORBIT readers, 85 percent of the respondents said they would prefer single-source ordering.

The majority of dish owners would prefer other programming distributors over programmers and cable operators. In a May 1987 survey of ORBIT readers, 68 percent of the respondents said they would prefer to buy subscriptions from sources other than programmers and cable operators. More than 80 percent stated a preference for a distributor other than cable operators:

Programmer—16%.
Cable Operator—3%.
Rural Electric Coop—26%.
Third-party (non-cable)—55%.

The conclusion is obvious. The present sources of programming subscriptions do not adequately serve this market. We need distributors who are independent of cable and programmers.

PROGRAMMERS HAVE REFUSED TO DEAL

Last fall I decided it was time to provide dish owners with a single source for all their scrambled programming. For this reason I formed Home Satellite Services. I accept the programmers' demand that anyone proposing to distribute their product to consumers comply with certain qualifications. I believe I can meet any reasonable qualifications for the following reasons: substantial financial backing; experience in retail program distribution as former owner of a cable system; credibility with satellite dish owners as owner of the leading satellite TV programming guide, Satellite ORBIT; credibility and current business relationships with home satellite TV retailers, who represent a vital link with dish owners; and a well-established business relationship with a company providing subscription, fullfillment, and billing services for my publishing company. This same firm is well-equipped to provide those same "backroom" services for HSS.

Bearing these credentials, I approached the leading programmers, prepared to negotiate in good faith for the rights to distribute their programming to dish owners. I am sorry to report that they were consistently unresponsive.

Some did not respond in spite of repeated attempts to set up meetings and pursue negotiations. (Viacom and HBO)

One programmer offered discriminatory terms. CBN Cable Network offered to sell its programming at the rate of $10 per year, or 83 cents a month. While CBN officials said this was comparable to the rate they charge MSO's, MSOs actually pay 10 cents a month for the service.

One refused to deal on the grounds that it was already acting as a "national package retailer." (Turner)

Another indicated that the wholesale price to HSS would have to be higher than to cable MSOs because cable has never paid enough, the cost of satellite transpon-

ders in the future may be higher, and possibility of copyright liability. (United Video)

For those of you who may attribute HSS's lack of success to poor qualifications or an inability to negotiate, consider this fact. No independent packager has had successful dealings with satellite programmers. There are several packages on the market today.

Programmer-controlled: (1) Viacom Satellite Networks (Viacom).

Cable-controlled:

(1) American NETLINK (TCI).

(2) Times-Mirror Satellite Services (Times-Mirror Cable).

(3) TCI.

(4) NewChannels/Vision Satellite TV.

Common-carrier: (1) Superstar Connection (United Video).

The only independent package on the horizon is the "Rural TV" package being assembled by the National Rural Telecommunications Cooperative. According to the NRTC's announcement, the package is a very limited one, offering nine basic channels, no regular premium services, and a pay-per-view movie service.

HSS has as its goal a package that offers the dish-owning consumer true one-stop shopping for the full range of scrambled services. We will not launch the product until we are able to deliver. Limited packages that might be considered acceptable because they compare to the selection offered to a cable TV subscriber are not sufficient. The satellite TV viewer expects freedom of choice. He knows that there is no technical limitation to the number of services he can receive. Now that some of those services are scrambled, he wants the convenience of ordering any or all of them from a single source, receiving a single bill each month, and being able to call one phone number when something goes wrong. Dish owners do not have that option today.

A MARKET HEADED IN A DANGEROUS DIRECTION

The market is moving in a dangerous direction. If present conditions are allowed to continue, home satellite TV will be controlled by its natural competitor, cable TV. The passage of S. 889 will ensure that a competitive distribution technology has a chance to develop independently.

Congress gave another fledgling TV distribution technology a level playing field not too many years ago. When cable TV was threatened with extinction because it was seen as a threat by the established over-the-air broadcast companies, Congress intervened.

All we ask is the same type of assistance from Congress, the same opportunity to create a new and better way to serve the public. Like the legislative solutions that were tailored to give cable TV room to grow, this bill is a conservative solution. I applaud Mr. Gore, Mr. Tauzin, and the other members who drafted this legislation. I will be glad to answer any questions you may have.

QUESTIONS OF SENATOR INOUYE AND THE ANSWERS THERETO

1. Should S. 889 be expanded to require programmers to remain on C Band satellites?

No. The purpose of S. 889 and the companion bill in the House is to encourage the development of a competitive market that will better serve home satellite dish owners. The emergence of direct satellite TV delivery via Ku-band will make it possible to use smaller, more affordable dishes to receive services. Such systems will be a competitive option to cable TV in more urbanized areas where large satellite dishes are impractical. At the same time, those who have invested in the current dish technology will be able to receive Ku-band signals by making relatively minor adjustments to their systems. Requiring programmers to continue using C-band satellites would be an inappropriate restriction that does not serve the interests of consumers.

2. Do you believe that a programmer could survive by just airing programs for dish owners?

No. The present universe of dish owners is not large enough to support a service created solely for their viewing. For example, Satellite Broadcast Networks, which markets a package of three network affiliates to dish owners, projects that it will take two to three years to reach the break-even point. To supplement revenue from dish owners, they are also marketing their services to cable TV companies.

3. There are some 70 unscrambled signals in service today. In light of this, why is it important that dish owners have access to scrambled programming?

An estimated 70 percent of dish owners today live in rural areas where cable TV and/or over-the-air broadcasts are not available. Therefore, satellite TV is the only means available to them to receive this programming. Since a system has emerged for delivering programming to these Americans and collecting fees, we see no reason to deny access to the services that are available to other Americans.

4. There are many programming services delivered via satellite that are not used by cable operators. Should these services be brought within the scope of S. 889?

No. The vast majority of these signals are back-hauls and other non-public signals that are not currently scrambled but could very well be scrambled in the near future. They are point-to-point private communications and most are not for public consumption and are of little interest to the home satellite viewer.

Generally, the programming services delivered by cable operators to their subscribers are the ones that should be available to dish owners.

5. Some cable programming comes via microwave systems. Should the public have access to such programming?

Most signals delivered via microwave are of local interest only and are of little interest to home satellite viewers. When a local signal is carried via satellite for national distribution to cable subscribers, then it should also be available to satellite dish owners.

6. Since you believe the actions of the programmers have been anti-competitive, why haven't you brought an anti-trust suit?

I am a small businessman who fully understands the cost of litigation particularly in gray legal areas of anti-trust. I would be at a considerable disadvantage in a legal confrontation with the major corporations involved in satellite programming that have staff attorneys and outside legal counsel on retainer. These firms also have the resources to drag out the process, file appeals, and generally play a waiting game to exhaust the resources of a small businessman.

7. Will the reinstatement of the syndicated exclusivity rules by the FCC have any affect on the home dish users?

If reinstated, syndicated exclusivity would tend to limit the programming available to the super-stations to the detriment of both cable viewers and home satellite viewers. Historically, broadcast has not been able to provide adequate service to rural America where more than 70% of the home satellite dish owners reside. Our surveys indicate just how inadequate broadcast delivery of network programming is:

Home satellite owners receiving POOR or NO reception of:

CBS	33%
NBC	35%
ABC	36%
PBS	51%

8. Should S. 889 be expanded to ensure that SMATV and MMDS operators also have access to scrambled programming at reasonable rates?

By deregulating the cable industry, Congress has created a natural monopoly that has been freed from rate control. Home satellite television, SMATV, and MMDS are all alternative delivery technologies that can provide competition for cable TV and serve the public interest and benefit the consumer. However, I would ask whether this is the appropriate piece of legislation to use as a vehicle for creating a level playing field for SMATV and MMDS as well as home satellite TV.

Senator GORE. Thank you very much.

Our final witness on this panel is Mr. Chet Grochoski, vice president for policy administration and corporate development with the Amway Corporation.

Did I pronounce your name right?

STATEMENT OF CHET GROCHOSKI, VICE PRESIDENT, POLICY ADMINISTRATION AND CORPORATE DEVELOPMENT, AMWAY CORPORATION

Mr. GROCHOSKI. "Grow Husky."

Senator GORE. "Grow Husky"?

Mr. GROCHOSKI. Yes, that is correct.

Senator GORE. Thank you. I apologize.

Please proceed, Mr. Grochoski.

Mr. GROCHOSKI. Thank you, Senator Gore.

Amway has come to testify in strong support of the legislation. We appreciate the opportunity to be here. In the past, we stayed on the political sidelines, but now we are here to tell it all—the good, the bad, and the ugly.

Senator GORE. A new hero is being born.

Mr. GROCHOSKI. The good is that we are the first non-cable distributor of programming to dish owners. The bad is that we have only one channel and have been unable to obtain contracts from cable programmers. The ugly is that the pernicious boycott of non-cable distribution continues.

The really ugly is that thousands of U.S. jobs have been lost because of these refusals to deal, and millions of American homes may never get the benefit of direct satellite reception.

Amway is well qualified to be a satellite program distributor. We are a financially sound, $1.3 billion a year company, making sales through 750,000 U.S. distributors. Our efforts to obtain programming contracts have been legion. We have negotiated in good faith.

Even when we say yes to every single demand and think that a contract is about to be signed, new obstacles are thrown in our face. It is a never-ending cycle of delay. We even offered to prepay 400,000 monthly subscriptions to one programmer and 300,000 monthly subscriptions to another. But we have not been able to get any contracts signed.

We have been shut out. Do we need legislation? Absolutely.

The prices being charged dish owners are monopoly prices. What is the evidence? Cable customers do not just buy programming. Their monthly bill includes a charge for cable equipment rental. The earth station owner bought his own equipment. The earth station owner is entitled to purchase programming alone and should not be stuck with paying for equipment which is not provided to him.

So when cable operators or cable programmers offer to sell programming to earth station owners at cable retail rates, they are gouging the earth station owner. Cable operators do not want home dish owners to have access to programming at fair prices, because they do not want to see cable subscribers switch to dish reception.

Every lost subscriber takes $2,000 off the cable operator's balance sheet. That is why cable operators and their cable-friendly pro-

gramming suppliers will not ever give the home dish owner a fair deal.

These anti-competitive practices need to be terminated. Congress needs to mandate non-cable distribution of programming. It also needs to require non-discriminatory wholesale pricing.

The wholesale prices being quoted to us for home dish distribution are often ten times higher than what cable pays. They are trying to force us to charge the dish owners the cable retail price in order to maintain their cable monopolies.

It has been almost a year since the Senate very narrowly determined that the marketplace needed more time to work. The marketplace is now nearly dead. The passage of the legislation will revive the satellite dish industry. Millions of rural Americans will know that they can safely invest their hard-earned dollars in satellite dish equipment and enjoy the same programming as their urban counterparts. Others will be able to purchase an alternative to cable if their service is shoddy, if their price is too high, or if they do not receive enough channels.

This legislation is a must win for the American consumer.

Thank you.

[The statement follows:]

STATEMENT OF CHET GROCHOSKI

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear before you and present testimony concerning the Satellite Television Fair Marketing Act of 1987. My name is Chet Grochoski. I am the Vice President of Corporate Development of the Amway Corporation. I come to testify in strong support of the legislation and urge its expeditious passage and signing into law. I do so because, in well over a year of trying, we have not been able to sign even one contract for home satellite distribution with any programmer that sells principally to cable television.

As has been recently said, we are here to tell it all: the good, the bad, the ugly. The good is that we are an independent-of-cable packager actually distributing programming (SelecTV) to dish owners. The bad is that we have been able to obtain no other contracts from so-called cable programmers. The ugly is that the boycott of meaningful independent-of-cable distribution persists. The really ugly is that thousands of U.S. jobs have been lost because of these refusals to deal and potentially millions are being denied the opportunity for direct satellite reception.

I believe my testimony may place my company in jeopardy of obtaining its goal through negotiations. But, we do not want to be played for a fool. It is time for the cable programmers to get down to business. We have stayed on the political sidelines until now. We have now been forced to vigorously pursue remedial relief through all appropriate channels.

I have been with Amway nearly since its inception in 1959. I have seen it grow, first-hand, from a home garage start-up to the second largest direct selling company in the world with 1986 sales reaching 1.3 billion dollars. Amway employs 7,000 people worldwide of which 5,000 are in the United States. There are nearly 2 million independent Amway distributorships worldwide with approximately 750,000 of them located here in the U.S. Amway's headquarters occupies 3.5 million square feet in Ada, Michigan, and we operate seven regional distribution centers in North America, as well.

Amway's Personal Shoppers' Catalog grosses over $100 million annually and is among the top ten mail order catalogs in the United States. Amway is Michigan's largest exporter of products to Japan and one of the U.S.'s largest exporters to that country. Not only are we one of the largest privately-held companies in the United States, but Amway also has the distinction of helping to create more entrepreneurs than any other company in the history of this great country. Amway distributors are trained, receive monthly, and often weekly, promotional and informational materials, attend seminars, and are generally very active members of their communities.

Amway distributors sell over 4,000 different products; many of these are services, such as pre-paid legal and travel services. Amway distributors are, for example, the single largest seller of MCI telephone residential subscriptions in the whole country. They sell more subscriptions than does MCI itself. Through the Amway Automotive Network, Amway distributors market the automobiles of all four major U.S. manufacturers. Based on this long-term, successful history in selling services and products, including the products or services of some of the largest companies in the world, it seemed to us that Amway would meet even the most stringent qualifications devisable for distributing subscriptions for home satellite programming.

The logic for satellite programming distribution through Amway is compelling. Satellite users were, and still are, largely rural, and so is a large portion of Amway's distributor force. Amway distributors sell mainly to friends, relatives, neighbors and acquaintances. It is a low-key and friendly approach. It is an approach that has succeeded for 27 years, during which time Amway distributors have sold a wide variety of products and services directly to American households. Amway has never enjoyed the benefit of operating under a governmentally granted geographic monopoly, as do cable television systems. People purchase from Amway because they want to; they do have many other alternatives. Our customers continue to purchase because we provide quality, we delivery promptly, and we give them their money back if they are not 100% satisfied.

We are additionally qualified to distribute satellite-delivered programming because Amway distributors are located in every urban, suburban, and rural community in the country. They possess the unique ability to call upon virtually every home earth station owner and personally present each with the opportunity to purchase a decoder and Amway's package of programming.

We believed that with our large sales force and our experience and expertise in selling products and services to a large consumer base, our company structure would be quite appealing to the satellite television programmers. It more than mirrors the distribution base that the programmers are accustomed to utilizing. That is, programmers are accustomed to having a large distribution base of cable operators selling programming. Amway presents a much larger distribution network than cable, a network that reaches into areas where cable has not yet penetrated—specifically those rural areas whee dishes are prevalent. In addition, we are financially qualified. We have done business with the largest companies in America and these companies can provide excellent references. Thus, we assumed we might even be considered by some programmers as the ideal distribution source. We believed we would attract as suppliers to us substantialy all, if not all, of the satellite programmers. How wrong we were; we do not appear to meet the minimum distribution qualifications of a single programmer that has a cable TV customer base.

Amway does not sit here simply as a spurned suitor. We are currently distributing satellite programming to satellite earth station owners. Approximately one year ago we acquired the rights to distribute SelecTV to the home dish market. SelecTV is a feature film service, similar to HBO, Showtime and The Movie Channel. It is very clear to us now that we were able to obtain the rights only because SelecTV does not serve the cable market. By dealing with us, it had nothing to fear in the way of retribution from cable operators. Its principal business has been to provide feature films to over-the-air subscription stations, multipoint distribution systems, SMATVs and hotels.

We entered the program distribution business in order to help protect our investment in the satellite television hardware business by ensuring a supply of programming to dish owners at a reasonable price. Some background for this decision is instructive. Amway first entered the satellite earth station field in 1985 by marketing a customer self-installed system in its Personal Shoppers' Catalog. We later developed, and began marketing in late 1986, our own satellite reception equipment. In the process of making a healthy investment in hardware research and development, we became aware that the potential for scrambling of signals was fast becoming a reality. We became aware that the cable operators—through the proposed, but now abandoned, NCTA consortium—were intent on controlling distribution and that several programmers were considering their own counter-consortium. We did not believe that consumer prices would be reasonable and thus attractive to current and future dish owners if there were a bottleneck in the distribution pipeline; i.e., a cable or programmer consortium controlling distribution.

We breathed a sigh of relief when both the NTCA and programmers rather simultaneously backed away from their plans to form a distribution consortium. We believed this was a healthy development, one brought about in important part by Senate and House hearings and the on-going investigation of the Department of Justice. We believed that the doors of the programmers would be open to our overtures.

Assuredly, if we knew at the time of your last hearings what we know now, we would have been clamouring then to appear before you. But our modus operandi at that time was to proceed as we would with an business venture, to proceed as we had time and time again in the past with other products and services. That is we simultaneously developed our distribution facilities and sought distribution rights from potential suppliers, all the while letting these suppliers know of our progress in distributing to earth station consumers. We believed that if we actively developed distribution facilities for delivery of SelecTV—and whatever else we could add to form a package—the programmers would not only note our seriousness, but would also realize that we could generate profits for them.

In brief summary, this is what we accomplished. Amway formed Starion Entertainment as a separate, wholly-owned affiliate of Amway Corporation. It is not staffed part-time by Amway employees with other job responsibilities. It has its own separate staff of 25 employees, its own separate building, its own separate name, address, telephone number, logo, identity and operating procedures. It represents one of the most elaborate commitments to a start-up venture ever made by Amway.

Starion established a computerized customer order center or "back office" located at Ada, Michigan. Customers wishing to subscribe to SelecTV or any other service to be offered by Amway simply dial 1-800-DECODE-1 to talk to any customer service representative. The representative will take the order and activate the decoder for the service selected. Starion's back office is on-line with American Express' First Data Resources subscription management system and lock box service (which also services Viacom), located in Omaha, Nebraska. First Data provides accounting, billing and authorization services. First Data is, in turn, interconnected to General Instruments' VideoCipher DBS Control Center in San Diego, California. In essence, this is a virtually identical on-line system to that employed by other packagers such as Viacom.

Starion sells to customers through three distribution channels: (1) direct response marketing; (2) satellite dish retailers; and, (3) Amway distributors. Direct response marketing includes advertising in the satellite TV program guides, direct mail, outbound telemarketing, and co-promotions with satellite dish equipment manufacturers. With respect to satellite dish retailers, over 1,200 of them have become Starion dealer affiliates. These retailers are intended to be instrumental in selling Starion's programming to new dish buyers.

Additionally, all 750,000 Amway distributors have been appointed Starion agents. They have the ability to contact, person-to-person, the roughly 1.8 million existing dish owners and personally present them with the opportunity to purchase a decoder at a discounted price and to subscribe to Starion's programming.

Starion dealer affiliates and Amway distributiors receive not only sign-up bonuses for new customers, but also residual bonuses for subscription renewals. The residual bonuses will be paid for as long as the subscriber remains a subscriber. This remuneration plan is unique in the industry. Starion is now successfully distributing through the above-outlined distribution system and channels. But it is distributing only one service, not a package.

Our efforts to obtain programming contracts have been legion. We have had scores of meetings, hundreds of telephone conversations, written on reams of paper, spent hundreds of thousands of dollars and expended thousands of hours of time. We think we are pretty savvy about negotiating and we have utilized virtually every negotiating strategy. In more than one instance we have even said "yes" to every single demand of the programmer. Just as we think a contract is to be signed, new obstacles are thrown in our path in a seemingly never-ending cycle of delay. This is in stark contrast to the opportunities awaiting a cable system. All a cable operator has to do is place one phone call and it can get a contract—without expending any of the above efforts.

Let me highlight a few aspects of our willingness:

Case No. 1: After several months of discussions with a programmer, we not only offerred to pay their asking price, but offered to prepay 400,000 subscriber months; that's a year's worth of programming for over 33,000 customers.

Case No. 2: After several months of negotiations, exchanges of several drafts of contracts, and caving into a price demand that was in the range of 6-25 times higher than that paid by cable systems, we threw in as an added incentive, prepayment for 300,000 subscriber months.

Cases No. 3 and 4: In response to services concerned with their wholesome, family image, Starion agreed not to carry "X" rated or "hard R" programming and we pledged not to distribute separately any "adult" services.

Cases No. 5 and 6: While some services will offer their programming directly, others, principally for economic reasons, will not. The latter will offer programming

through one or more packagers. However, Starion has offered to any service that distributes through it the ability to make its service directly available to consumers. That is, Starion would provide all the back office functions: customer service representatives, interconnection to billing, acscounting and authorization facilities as well as interconnection to the DBS Control Center. The customer (programmer) could have its own 800 number and the phones would be answered in a manner customized to the needs and identity of the programmer. Its records would be maintained independently and confidentially from Starion's.

Case No. 7: With respect to a programmer that needed blackout capabilities, we offered to blackout the programming where required right down to the nine digit ZIP code.

As previously stated, no matter which approach we took, no matter what we acceded to, a contract was never the result. To be sure, no programmer has said the equivalent to "go jump in a lake" or "never call us back". But we have heard every other possible excuse, to say nothing of the innumerable unreturned phone calls. Perhaps a few highlights would be helpful.

Case No. 8: A large distributor of feature films has made it very clear in direct conversations, in press interviews and on trade-show panels, that it would only sell through cable or directly by itself. A representative of the company attended a seminar. In response to a direct question from the audience, he responded, quite emphatically, that he would license other entities to sell to the home earth station market. I wrote stating that it was my belief that this represented a change in policy. I asked under what terms and conditions he would be willing to license Starion to market his respective services.

He wrote back:

"There has been no change in our policy in serving home satellite system owners . . . we sell HTVRO owners directly and we also grant a similar right to cable operators. What I said . . . was that, although we were not seeking to change our policy we would 'entertain any serious proposal'."

Case No. 9: When we indicated to one programmer that we would aggressively sell our pacakge—including his service—(something I thought he would appreciate) he said that he didn't want us to sell too cheap and undercut cable operators."

Case No. 10: After months of talks with a major programmer, the programmer decided to market, not by itself, but through cable affiliated packagers. Because the programmer was busy renegotiating contracts with cable operators, they did not want to do anything that would jeopardize those negotiations, such as entering into a noncable distribution contract.

We could go on and on. The simple fact is that no contracts have been signed with programmers that principally rely on cable as a customer base. Have we been shut-out? Undeniably. Do we need legislation? Absolutely.

POLICY ISSUES

There are three policy issues that Amway wishes to address that bear directly on the need for legislation.

NonCable Packagers

Much of the focus in previous hearings has been on the subject of so-called "third party packagers". We believe this to be a serious misnomer. The issue is the need for noncable packagers. Simply stated, the question is whether or not home earth station consumers will be able to obtain programming from parties that are either: (1) not owned by cable companies; or, (2) highly dependent on cable companies for their existence. It should be overwhelmingly apparent by now that dishes do compete with cable. To the extent that cable, or those friendly to cable, are allowed to keep a stranglehold on the prices charged to the consumer, we will not see further substantial development of the satellite dish industry and all the benefits it provides to the public.

Because consumers have to pay to view programming, the consumer must perceive a competitive advantage to buying a dish over subscribing to cable. To be sure there are non-price advantages; not having to deal with the local service representative of the cable company for repairs or service outages; and, in many cases, a much larger variety of programming is available. But when it comes to making an investment of $2,000 or more, most families are going to do the arithmetic and are going to want favorable program pricing, vis-a-vis cable, before spending such a large sum.

From cable's point of view, at today's market prices, there is $2,000 loss from the balance sheet of the cable operator for every subscriber that switches from cable to an earth station. As a consequence, cable operators (or their "cable freindly" pro-

gram suppliers) are not going to price service to dish customers below, or significantly below, the cable retail price. They simply do not want to see defections from cable. As long as dish subscriber prices cannot be reduced below the cable price, consumers will continue to stay away in droves from purchasing earth stations. In pure economic terms, in cabled areas, there is no or little demand to purchase dishes when the utilization cost of dishes is relatively the same as that of the substitute rental product (cable TV).

It is only a noncable packager that has the strong incentive to make a profit in this market and that will not only want to undercut the local cable operator's price for programming, but will not suffer, or fear suffering, retaliation for doing so.

Nondiscriminatory Terms and Pricing

We believe this is a critical element of the legislation. As we understand the legislation, if any programmer delivers the programming through any entity other than itself, it must establish criteria under which companies such as ours may qualify to distribute the programming. The programmer must also not discriminate in price, terms, or conditions among different distributors offering similar distribution services to the consumer. We understand this to mean that if a programmer offers programming to cable operators for $.05 per subscriber, it would have to offer the programming to a distributor such as ourselves at the same price, i.e., $.05 per subscriber. Presumably volume discounts would be allowed so that, for example, TCI would pay less under volume discounts than would Amway given the disparity in the number of our customers. On the other hand, Amway would not have to pay any more for the programming under the legislation than would comparably sized cable operators.

This concept is extremely important because the prices being charged by the programmers for home dish distribution often are orders of magnitude higher than that charged to cable systems. For example, one programmer charges smaller cable operators $.24 per month for its two services and we estimate that it charges some of the larger MSOs less than $.05. This same programmer wants to charge us $1.25 per month for the identical programming package. Similarly, all of the programmers we have negotiated with have sought substantial multiples of the price that they charge to cable.

It is instructive to note, at this point, that the cable operators which distribute to home earth station owners appear to be willing, very willing, to pay these prices because it sets a high floor for the price of programming to dish owners. This presents price competition by noncable distributors—should we ever actually get into the business.

Let us look at what this means in practical terms. It means, hypothetically, that ten services that cost a cable operator, $.20 a piece or $2.00, would cost Amway $10.00 or more. This would ensure that Amway would have to charge dish owners the cable retail price in order to barely scratch out a profit. As a result, consumers will not purchase satellite dishes.

On the other hand, if Amway could purchase at the cable wholesale price, it could provide a retail price to a consumer that adequately gave credit to consumer's investment in his earth station equipment. Let's face it, the earth station subscriber is entitled to purchase programming at a lower price than is a cable subscriber because of his investment in the equipment. Typically, a cable operator's subscriber revenues are thirty to fifty percent consumed by costs related to the depreciation, maintenance and operation of the physical plant. These costs are all borne by the dish consumer. Thus a substantial differential in his "subscriber fee" is economically justified. If this were to occur, consumers would once again find that new investments in earth stations are attractive.

In this regard, many of the programmers will point out that the prices charged to dish customers are not out of line with, and perhaps, in some cases, even somewhat less than those charged by local cable operators to their cable customers. But this cannot be relied upon. First, where these charges are less, they are only marginally but not meaningfully so. Secondly, if the potential noncable competitors never get into business, the cable packagers will be able to raise their rates—at will—because there will be no competitive check. The only reliable method of keeping prices reasonable for dish owners is by having independent programming packagers that can buy at the wholesale price from program suppliers, just as cable operators do.

In this regard, it must be pointed out that the only realistic check on cable rates, now that the deregulation has occurred on these rates, is the competition that can be provided by satellite earth stations. But day-by-day that competition is being eliminated as consumers stay away from purchasing satellite earth station equipment.

Access to Programming

Nondiscriminatory rates and noncable packaging, of course, depend on the basic issue of access. S. 899 ensures access to programming that is encrypted. The legislation is appropriately frequency blind. It does not make an exemption for K-band or Ku-band transmissions.

We note that the legislation is somewhat different from the legislation before you last year. The requirement to establish criteria under which distributors may qualify to distribute the programming seems to be triggered by a condition that the programmer, in fact, distribute through someone else other than itself, *e.g.*, through cable. While this restriction may not present a problem today, there has been considerable indication that programming on higher frequency bands may be deemed "cable only" by the programmers. If that were the case, Section 605(2)(C)(3), which requires making the programming available for home satellite antenna users, would result in distribution to dish owners only by the programmer. That is, cable would have a de facto exclusive for cable customers and the programmer would have an exclusive for dish owners. This would eliminate the competition to cable that would be provided by earth stations because programmers will continue to sell at, not below, the cable price. We believe the Subcommittee, at the appropriate time, should consider the closing of that significant loophole.

CONCLUSION

Amway has made a sincere and dedicated effort to become a noncable packager of programming. We believe we are eminently qualified to be a packager. We believe it is essential to the survival of the satellite earth station industry and to the potentially several million customers that can be reasonably served by satellite earth stations that this legislation be passed. It has been a year since the Senate very narrowly determined that the marketplace needed more time to work. The marketplace is now nearly dead. Surely this legislation will be supported by the American public.

The passage of the legislation will revive the satellite dish industry. Prices for programming will be reasonable. Millions of rural Americans will know that they can safely invest their hard-earned dollars in satellite dish equipment again and enjoy the same programming as their urban counterparts. Suburban and urban dwellers will be able to purchase an alternative to cable if their cable service is shoddy or does not present enough viewing choices. The existence of dishes in cable operating territories will effectively serve as a nonregulatory restraint on constantly rising cable consumer prices.

This legislation is a must win for the American consumer.

Senator GORE. Thank you very much.

For my colleagues and all those in the hearing room today, there is a voice which should be heard in these hearings that we're not going to hear. The major programmers, including HBO and Showtime, were invited to testify.

The committee worked with them and asked them who they would prefer to give their point of view. They agreed that Showtime would be the spokesman that could put the best face—well, for whatever reason, they agreed that Showtime would be the one to testify.

And then just a day before the hearing, they pulled out. We have not been in the habit of issuing subpoenas, but I want to express regret that ViaCom Showtime chose not to appear.

We need answers to serious questions from not only Showtime, but HBO, ESPN, Disney, USA, and others. I intend to submit questions in writing to these companies for the record, and I want to encourage other committee members to do the same.

Senator PRESSLER. Mr. Chairman.

Senator GORE. Yes.

Senator PRESSLER. I wonder, since the problem seems to be the leading programmers, if we could have another hearing, a so-called day with the leading programmers.

Senator GORE. Well, that certainly suits me, Senator Pressler, and we will pursue that at the appropriate time, because they seem to be the problem. We will pursue that. But certainly that is a major part of the problem.

In any event, I wanted those following these hearings to understand why they were not here. They pulled out at the last minute. Now, they will have to answer for themselves as to why they pulled out at the last minute.

Now, I am authorized to announce that a new co-sponsor of S. 889 is being added now, and that is the chairman of this committee, Senator Fritz Hollings. And that is a welcome development.

We are going to now go to a five minute rule for the first round, so that everyone will get a chance early. And then we will come back in anticipation of a second round.

If I may begin with my five minutes, I will just start by again directing the attention of our first panel to the chart which has been put up there. And I have asked the staff to pass out Xeroxed copies of that since it is a little hard to read from this distance.

What that illustrates is that the two private third party distributors, each with substantial assets, of unquestioned business ability, have approached these leading programmers and have been refused by every single one of them.

The NRTC, an outgrowth of the National Rural Electrical Coops Association, also testifying here, has approached all the leading programmers and has had success with only two, the Christian Broadcasting Network, which, not coincidentally, is independent of cable ownership, and CNN Headline News, which is partly independent, although TCI has purchased a major part of their company.

Now, I would like to go back to the first chart. If those handling the charts would go back to the first chart, this illustrates home TVRO distribution. On the left hand side you see the name of the programming service, the premium programmers at the top and the basic services following below.

And then in the second column you find the ownership of the leading program services. And as you can see, the cable industry is quite prominent, indeed dominant, in the ownership.

Now, in the third column you will see what is their rule for distributing their programming. You will see that HBO and Cinemax has a rule that it will distribute directly, but it will not deal with anyone else unless they are a cable television company.

That is anti-competitive in my opinion. You will see the same thing is true of Showtime and Movie Channel. Disney has not resolved its policy yet.

ESPN, no one except cable companies. CNN-CNN Headline, as I noted, they are an exception. USA, only cable companies. CBN, they have an arrangement with a third party packager.

MTV, only cable companies. Nickelodeon, only cable. Lifetime, VH-1 and Discovery, only cable companies.

The next chart, please, illustrates the cable ownership of the leading programming services. Viacom is the owner of Showtime, Movie Channel, MTV, Nickelodeon, Lifetime, VH-1, the Black Entertainment Network.

ATC/Time Incorporated is the owner of HBO, Cinemax, USA network.

TCI, from whom we have heard, is the part owner of CNN, the BET Channel, Discovery. CNN, WTBS part owner, and the Rainbow Network.

Next chart, please.

Now look at the wholesale prices in the far right hand column of this chart. The estimated wholesale price of HBO is four to five dollars per month. A cable customer on average, according to our figures, is charged $11.50 per month—excuse me. According to the chart, that is the Arlington Cable.

The TVRO owner, more than that, almost $13 a month. Look at the discrepancy between that price and the wholesale price. And again, it is not for us to determine what that discrepancy ought to be, nor is it for a single company to determine it.

It is for the marketplace to determine what the writeup is going to be, what the markup is going to be. I heard the testimony earlier from Mr. Mooney about something being provided at a reasonable price. In my opinion, a reasonable price is one that is determined by the marketplace when competition is present.

Moving down the chart, you can see the wholesale prices estimated for Showtime and Disney are at a comparable level, and then—well, let us look at Showtime for a moment, because we heard about the deep discount. The deep discount is if you pay twelve months in advance.

Are you familiar, Mr. Mooney, with any cable customers who are asked to pay for their programming for an entire twelve months in advance?

Mr. MOONEY. There are still some rural systems that practice that method of marketing, yes.

Senator GORE. Well, I did not know about that. There are not any that I have come into contact with, and I will bet you that their customers are mighty unhappy about paying a full 12 months in advance.

In any event, I would submit that it is not a deep discount.

Mr. MOONEY. Senator, if I could out——

Senator GORE. But the point—well, go ahead and then I will make my point.

Mr. MOONEY. We want to be very candid with this committee and we want to give you all the facts and not mislead you. You will therefore see on our chart that for the Showtime package we show the monthly price if paid monthly and the monthly price if paid annually.

The monthly price if paid monthly for the entire package is $17.95, which is still a very significant discount over the average $23.13 paid by the cable subscribers.

Senator GORE. Well, when you look at those packages it can be very, very misleading, because if you have to buy a la carte as a dish owner for all of the services that are available, exclusive of a few that one company is offering in a package, then the cumulative cost is many, many times what would be paid by a cable customer.

But the central point is that the marketplace ought to be setting those prices, and common sense tells me anyway that the marketplace would serve to drive those costs down.

My time is up. I see Mr. Thomson wanted to—I mean, excuse me, Mr. Wolford wanted to say something.

Go ahead, Mr. Wolford.

Mr. WOLFORD. Mr. Chairman, what is bothering me is that they show twelve basic services up there. I do not believe all those twelve basic services are scrambled. Is this another Chinese shell game that we are playing here?

Mr. MOONEY. Mr. Chairman.

Senator GORE. Are the basic services one that are scrambled or not?

Mr. MOONEY. They include all of the basic services.

Senator GORE. Scrambled and unscrambled?

Mr. MOONEY. It includes all of the basic services which have scrambled thus far, plus about a half a dozen which have not. But as you know, Senator, the dish amendment to the Cable Act of 1984 specifically allows the programmers to charge even for an unscrambled signal if they so choose, and then viewers are on the honor system.

Mr. FINN. Mr. Chairman, there are a couple of other problems with that chart up there that are not mentioned. Number one, nowhere do they include the fact that there is a decoder charge.

Number two, the Showtime package is far, far from complete. It does not have HBO, it does not have Cinemax, it does not have Disney, it does not have any of the super stations.

Number three, Showtime was referred to earlier this year as the "sick puppy" of the industry. It has some severe financial problems. It has just undergone a change in management. We saw a letter from Daniels (a major cable operator) come in to them and pressure them within the last month.

I do not know how long they are going to be in the packaging business, but I sure would not want to pin my hopes on just one company anyway. We need more than that. We need a universally available package of programming by a third party which is independent of the cable industry.

Thank you.

Senator GORE. Thank you.

I have gone over my time. Senator Packwood.

Senator PACKWOOD. Gentlemen, you are going to have to bear with me a moment. I have never lived in an area that has cable. It had not arrived in Portland when I left and I do not live in an area that has it yet here. So I need to understand some basics.

I will start with Mr. Mooney. Your organization represents both the cable distributors and the companies that create the programs, is that right?

Mr. MOONEY. As associate members, yes, sir.

Senator PACKWOOD. Okay. Now, when we say create the programs, we literally mean things like producing a movie or producing a program that is beamed up on the satellite. They are not the satellite owners, they are not the cable distributors, other than the cable system may own them. But they do the program, make the program, create the program; is that what a programmer does?

Mr. MOONEY. Either create it themselves or obtain it from others who do.

Senator PACKWOOD. Okay.

Now, you make reference in your association to 71 cable programming services. Does that mean that there are 71 programmers who belong to you, or what are 71 programming services?

Mr. MOONEY. That means 71 channels, if you will, that are distributed nationally to cable systems for distribution—for sales to cable subscribers.

Senator PACKWOOD. All right. On this list that Senator Gore has, where it lists Viacom, Showtime, Movie Channel, MTV, Nickelodeon, Lifetime, VH-1, and Black Entertainment Network, those are all programs put together by Viacom?

Mr. MOONEY. I think all except BET and Lifetime are owned by Viacom.

Senator PACKWOOD. And Viacom buys Black Entertainment Network and puts it out as part of its program?

Mr. MOONEY. That is correct, sir.

Senator PACKWOOD. Now, would Viacom—would all of these be counted as separate programs, or is Viacom with its entire package counted as one programming service?

Mr. MOONEY. Well they are selling the so-called basic service, comparable to cable basic service, as a package.

Senator PACKWOOD. I did not ask my question right. Of 71 cable programming services, if I listed seven there, would that count as seven of the 71? Or does Viacom count as one company of the 71?

Mr. MOONEY. That would count as seven of the 71.

Senator PACKWOOD. All right.

Is there reasonable competition between programming services?

Mr. MOONEY. There is an enormous competition that has gone on in the industry amongst the basic services for channel exposure on cable systems, and in many instances the basic services will provide a similar look. So they compete with each other, not only for channel positions, but also for viewership.

The competition within and amongst the pay services I think is easily one of the most fierce competitions going on in the American economy today, and people who are familiar with this industry treat as a byword this fierce competition, which occasionally almost seems to deteriorate into hostility, between HBO and Showtime.

Senator PACKWOOD. I want to ask the rest of you. I want to go down the rest of the panel now, because you have got some opposed to the bill and some in favor. And so let me start with Mr. Finn on that question. In your judgment, is there a reasonable competition among the programmers?

Mr. FINN. No, Senator, in my judgment there is not, and I think it is borne out by the record. Last year some of those packagers were charging a higher rate. The Senate and the Congress forced——

Senator PACKWOOD. Much higher rate than what?

Mr. FINN. Than what they are charging now.

The Senate and the Congress looked at them. They were kicking back five dollars to every cable operator for any sale that was made to a dish subscriber in their franchise area.

Senator PACKWOOD. You are missing my point. Do Viacom and Home Box Office go at each other tooth and nail in trying to woo each other's customers and beat each other?

Mr. FINN. Not with respect to the home satellite market. When Congress forced them to drop the kickback that was formerly going to the cable companies, the rate to dish subscribers did not come down five dollars.

If they are really in a competitive marketplace and Congress would force them out of that kickback situation, I would think that price would have come down.

Senator PACKWOOD. In your judgment, are they in collusion with each other?

Mr. FINN. I do not know in a legal sense whether they are in collusion or not, but I do know when you look at the marketplace there is no real competition, HBO does not even have a real package of programming. How they can say they are aggressively pursuing this marketplace is beyond me.

Senator PACKWOOD. Mr. Carp. Just let me go down the line. Do the programmers compete?

Mr. CARP. Senator, from the point of view of Turner Broadcasting, there is no question——

Senator PACKWOOD. From the point of view of what?

Mr. CARP. Of Turner Broadcasting. There is no question that not only are the basic cable programmers, which is what we are, competing vigorously with one another for audience share, for advertising, for space on cable systems, but because we are basic cable networks we are also all competing with all the local broadcasters around the country.

Also we exist in a very competitive marketplace, where we compete with each other and we compete with the local broadcasters.

Senator PACKWOOD. Mr. Phillips.

Mr. PHILLIPS. Yes, sir, there is competition among the programmers. But I think we recognize that there are certain programmers that offer unique products that stand them apart from others. And some of those have been very difficult, if not impossible, for us to deal with and reach agreements with, to offer them either in a package form or a la carte.

Senator PACKWOOD. Now, give me a for instance. How do some of these programmers manage to carve out a niche that basically, for whatever reason, becomes uncompetitive?

Mr. CARP. As an example, you might take a specific area of interest, such as health programming or family entertainment or movies, things of that nature.

Senator PACKWOOD. My time is up. If I could just go down the rest and have you answer the question as to whether or not the programmers are competitive.

Mr. PITSCH. Senator Packwood, the programming industry appears to be quite rivalrous. The initial prices have fallen over time, Home Box Office's prices for example, or the price of Showtime's package.

Home Box Office's behavior in picking a standard initially, requiring M/A Com to reduce the price of the decoder and to increase the compatibility with dishes—we have seen lots of evidence of rivalrous behavior.

Senator PACKWOOD. Go ahead.

Mr. WOLFORD. Senator Packwood, I do not think that they are competitive. And the thing that keeps occurring to me, and as I explained to my——

Senator PACKWOOD. The thing that what?

Mr. WOLFORD. They are not competitive.

Senator PACKWOOD. No, I heard that. But then you said the thing that——

Mr. WOLFORD. Well, the thing that is starting to bother me is, you know, I am hearing basically the same story from each one of them. These folks are not new to me. I have been in the cable business for a number of years and grew up with them, see.

And either they have all had the same electric therapy shock treatment or they have gotten together, because they are all telling the same story. And cable is bound and determined to control both the wired world and the wireless world, to the detriment of the consumer at large.

Senator PACKWOOD. But your basic position is that the programmers are not really competing, there is some collusion between them somehow?

Mr. WOLFORD. There is some conclusion——

Senator PACKWOOD. No, collusion.

Mr. WOLFORD. Collusion, that is correct.

Senator PACKWOOD. The other two on this left end here? I already had Mr. Mooney's statement.

Mr. GROCHOSKI. In my view, the programmers are competitive when you look at the cable distribution of their programming, but that is where the prices are very aggressively low.

It is when you get to the home dish distribution where they do not compete with one another, and the prices are incredibly high.

Senator PACKWOOD. Okay.

Mr. THOMSON. It has been our experience and judging from our contacts with the programmers in our attempts to serve both our dish owner customers and our cable customers, that they are competitive. There is a substantial amount of competition amongst the programmers.

I would also like to make a point before I close, Mr. Chairman, about our respective prices that we charge cable subscribers and dish owner subscribers. I do not know whether now is an appropriate time to do that.

Senator GORE. We will give you a chance. We will give you a chance.

Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

It appears that we are trying to address with your legislation and get information in this hearing on two basic aspects of this problem. One is access. Mr. Wolford showed us a chart that shows us that around half the people in the states that he showed on his chart do not have access.

And of course, then the other problem is cost, and cost cannot be separated from the access issue, because if it is prohibitively expensive obviously people are deprived of access in that fashion.

And we have now two different charts here. One of them shows that HBO—excuse me—an HSD owner paying basically the same amount of money, or even in that example somewhat less than the

cable subscriber. And yet, we have other witnesses here who have testified that the cost to the HSD owner is substantially higher.

I think we need to get that resclved, and perhaps I can ask who is the point and counterpoint here, perhaps Mr. Wolford and Mr. Finn, and then either Mr. Mooney or Mr. Thomson, to make the case here.

Mr. FINN. Senator. there are two types of services, basic services and premium services. The gentleman from the NRECA has already said when he contracts for the basic services they charge him between 500 and 800 percent above what they charge for cable. I think there is no question about basic services.

The question comes in the area of the premium services—the Showtimes, HBO's, things like that. The statistics that you are seeing up there on the chart do not include a number of things. They do not include the cost of the decoder. Also, to get the best rates for programming, you usually have to buy a year in advance and you may have to buy a package with programming you do not wish.

Most important of all is what Senator Gore alluded to earlier, that is the dish owner has already purchased his reception equipment, his distribution equipment. The cable operator is spending two to three dollars or something along those lines per month for his distribution plant. So the prices should be a great deal different, dish subscribers should pay less.

Mr. WOLFORD. Senator McCain, let us just for the point of it say that the prices of cable and the prices of home satellite are direct. Now, the investment that a cable subscriber makes is $25 up front to be installed. 74 percent of the 1.8 million home satellite owners have paid in excess of $2,000 for their system.

What they basically did is took part of the cost that the cable company would normally take, because they do not have service. They are those second class, underserved television citizens of the United States.

Senator MCCAIN. Mr. Mooney, would you like to respond?

Mr. MOONEY. Certainly, Senator.

This business is really in packaging. Pay television in order to be a reasonable proposition for the consumer almost always has to be sold as part of a package. Otherwise the transactional costs of trying to sell the services one by one would be prohibitive.

We would not be—the cable industry would not exist were it not for packaging. What I have illustrated over here is simply an example of the best known package currently on the market for home dish owners as compared to the average price now being charged to the cable customers for the same thing.

It could be a little bit less for that package as it is in the Media General System in Fairfax County, it could be a little bit more as it is in the Hauser Communications System in Montgomery County.

And in my prepared testimony, we have attempted to gather all of the different prices and various kinds of packages which are currently available to the home dish owner.

I would go back, however, to what Mr. Carp said in his prepared statement, that this is a market which is just beginning to develop in terms of the programming services actually scrambling. There is only a very small number of them which have scrambled thus far,

and as more scramble you will see more of these packages come on line.

You will see an HBO package, I think, within the next few weeks, and I think you will continue to see a consistent pattern of the price being significantly lower than that charged to the cable customer.

Senator MCCAIN. I have several more questions. Mr. Phillips maintains that you will not allow NRTC to purchase your package, is that correct? True or false?

Mr. MOONEY. Me? I'm the trade association.

Senator MCCAIN. The cable company.

Mr. MOONEY. Well, I am the trade association. But I think that is certainly——

Senator MCCAIN. It is what?

Mr. MOONEY. Is the question that the cable industry will not allow——

Senator MCCAIN. NRTC to purchase their package.

Mr. MOONEY. Well, he has apparently purchased the rights to quite a lot of them already, including ESPN, which is the most widely distributed cable basic service in the United States.

I think what he is saying is that he has made contracts with a group of them, he now encounters some others who want to distribute themselves, and proposes that Congress should make a law giving him the right to have a contract with them, too.

Mr. PITSCH. Senator, if I might comment on that question, because I think your first question goes to the heart of the matter, which is what is the access to programming and what is the price of the programming to consumers?

I do not believe third party distribution should be a litmus test as to whether or not this marketplace is working. And if in fact the prices, because we see Home Box Office and the other program providers competing, are quite reasonable, comparable to cable, then I think that should be the public interest test here.

I think part of a marketplace is to allow owners of products to pick that distribution system that they think is most efficient. We would not, for example, contend that there is a lack of competition among the three networks, the major networks, because they each choose to exclusively distribute their programming through one local affiliate, and we see the networks competing in acquiring those affiliates and acquiring programming and ratings.

And yet, the American public has very much benefited from the competition at that national level, even though there is only one outlet in any local market. And exclusive distribution can be very efficient.

The network is a good example. It reduces the cost of acquiring programming. It facilitates the promotion of programming. It facilitates the selling of nationwide advertising. All of these things can flow from exclusive distribution arrangements, and those should only be a problem if in fact there is some market power.

And so, even though I am flanked by two gentlemen who are interested in getting into the third party distribution system, and oftentimes third party distributors can add a lot to the market, the fact that a marketplace does not manifest third party distribution does not mean that consumers are not being well served.

Indeed, it might mean that they are being better served.

Senator McCain. My time has long ago expired, but let me just say that it may be that third party distribution should not be a litmus test, but to totally exclude the possibility of third party distribution in my opinion is also unfair to the consumer.

And I do not see why you would exclude that. And the networks do have competition. If there is only one distributor in an area, then there are not three or four, now four networks, which are available who do compete for ratings.

There is no rating competition if there is only one distributor.

I am sorry for exceeding my time, Mr. Chairman.

Senator Gore. I think Mr. Phillips wanted to respond also.

Mr. Phillips. I would, please.

Senator McCain. And Mr. Thomson did, too.

Mr. Phillips. I think it is preposterous that the government witness would suggest that there is a fair—or a price equality in the marketplace here. We have testified, and I can back it up, that the prices we have been asked to pay exceed the cable wholesale price by 500 to 700 percent. And we have gone to the programmers advising them that we have put everything in place, from an automated authorization process to customer billing and complete service, to make everything available that a cable company makes available to a customer.

And yet, we have no price comparison at a wholesale basis. We understand what it means to string wire and line to a customer, and we would like to offer this service to millions of rural Americans who will not be able to afford $1,000 to $2,000 for a dish, $400 for a decoder, another $200 to $300 up front for an annual subscription.

We want to make it available on a monthly basis, just like cable. We want to help with financing, true customer service, billing, and all the things that go with it. But yet, we are denied the same fair terms and price that a cable company would be offered by a programmer.

That to me is the real point here.

Senator Gore. If I could interject a comment. One thing that has not been mentioned is they are technological competitors, and one industry has a self-interest in seeing the failure of its technological competition and it controls the source of supply for its competitor. And so it is squeezing off the source of supply.

And you see 60 percent of one industry going bankrupt in one year, while the stock of the other industry goes up 60 percent in one year, and the market penetration is ten percent among satellite dish owners. It is not that complicated.

Senator Danforth.

Senator Danforth. I want to ask all my questions to Mr. Pitsch, so everybody else can relax.

Mr. Pitsch. Somehow I had that feeling.

Senator Danforth. Mr. Pitsch, whether or not there is competition among programmers, there is no competition among cable operators, correct?

Mr. Pitsch. There is generally only one cable system serving a market.

Senator DANFORTH. Can you think of any case where there is more than one cable system serving a market?

Mr. PITSCH. On occasion there have been, but that is not usually the——

Senator DANFORTH. It is nonexistent, really, is it not?

Mr. PITSCH. That is correct.

Senator DANFORTH. So there is no doubt at all that there is no competition among cable operators?

Mr. PITSCH. There is no competition among cable operators, but I would argue that the relevant, the better question——

Senator DANFORTH. I am not asking you what is relevant or what the better question is. I am asking the questions.

It is a monopoly. Right?

Mr. PITSCH. I do not believe that——

Senator DANFORTH. You do not believe it is a monopoly?

Mr. PITSCH. I do not believe it is a meaningful monopoly. No, Senator.

Senator DANFORTH. OK. So you think, when you say that there is a marketplace, and that is your word, when you say that there is a marketplace, you are saying that competition in who gets the programming into a person's home. Right?

And that the cable system is not the only way that the TV programming is getting into the home. But it is coming from a variety of sources.

Mr. PITSCH. Yes, Senator. There are some instances, of course, where cable systems, given propogation characteristics, are the only means of getting programming that we——

Senator DANFORTH. I cannot imagine that you are contending that where somebody is on a cable service, that cable service is not the sole source of cable programming into the home.

Mr. PITSCH. Senator, I believe that the possibility of over-the-air broadcasting can provide a substantial check on the behavior of a cable system, because the threat that a substantial number of its subscribers would leave if it raised its price—and put up antennas or use antennas that are already there, or use VCRs, which offer programming at competitive prices with certain advantages—can prevent them from acting like true monopolists, and therefore that this market, although I am not going to conclude is workably competitive, does have some substantial degree of substitution.

And that is beneficial to consumers.

Senator DANFORTH. What do you mean, substitution?

Mr. PITSCH. I mean that——

Senator DANFORTH. You mean, when you are at home at night you can do something other than watch TV?

Mr. PITSCH. I mean that many households have alternatives to cable, and that potential does provide a certain——

Senator DANFORTH. What are they?

Mr. PITSCH. Over-the-air reception.

Senator DANFORTH. What does that mean?

Mr. PITSCH. That means receiving——

Senator DANFORTH. From satellites?

Mr. PITSCH. From satellites.

Senator DANFORTH. Well, that is what we are talking about. We are talking about whether there should be, is that not the point of

this legislation? Whether there should be other sources in getting programming into the home other than the cable?

I mean, that is the whole thrust of the bill, as I understand it.

Mr. PITSCH. It is my understanding that the thrust of the bill, there are four broad thrusts. I will not attempt to characterize the Chairman's legislation.

But one key part that I think goes to this line of questioning is whether or not third party distributors are able to also provide programming to those——

Senator DANFORTH. And you are saying that even without that, there is competition in getting this programming into the home.

Mr. PITSCH. I believe that there is. I believe that——

Senator DANFORTH. How so, if there is scrambling? How do you get your TV programming into your home if there is scrambling, other than through the cable?

Mr. PITSCH. The first way you could do it is to acquire the Showtime package, with 12 basic services and two pay services for less than the price of the cable programming available——

Senator DANFORTH. But there is no competition among distributors, is there? There may be among programmers, but there is no competition among distributors.

I mean, to get the product into the house, it is an absolute monopoly, and further it is an unregulated monopoly. Is it not?

Mr. PITSCH. The dish owner would have the choice of getting his programming from a variety of programmers. And I take it——

Senator DANFORTH. That begs the question. I am not talking about competition among programmers. I am talking about how you get the product into your house. There is the monopoly. Is there not?

Mr. PITSCH. I do not believe that there is a monopoly.

Senator DANFORTH. Okay. You are saying that other than getting a scrambled program through your cable, you can get it in some other way.

Mr. PITSCH. It depends on the programming, of course, Senator. For broadcasting, what we typically call broadcasting, there is an alternative in many cases. That is, the use of an antenna and receiving the signal over the air.

As to many premium programs, there is an alternative that many households, indeed well over 40 percent of the households, many of whom are also dish owners, indeed probably half of the dish owners have VCRs. So they also have that alternative.

Now, it is not——

Senator DANFORTH. What does that mean, have VCRs?

Mr. PITSCH. That means that given the availability of a VCR, they can, rather than buy Home Box Office, over——

Senator DANFORTH. Go out and rent a movie. See a different movie.

Mr. PITSCH. And, I believe the evidence suggests, although I cannot demonstrate complete causality, that in fact the VCR market has had a very pronounced effect on subscribership to Home Box Office.

Now, my point, Senator, would not be that there are no problems in this marketplace. I would not say that. I am not saying that the

transition in this marketplace has been smooth and without problems.

Indeed there has been a lot of uncertainty. We have seen dramatic changes. A dramatic increase in the effective price of the dish, because people now had to start paying for this programming that heretofore they did not have to pay.

So we do see a lot of disruption. But on the other hand, I would make two points. First, that we do see progress. We do see a number of the concerns that people had in this area, whether or not there would be a standard, whether or not programming would be available, whether or not there would be packages. We see progress on that front.

And then secondly, I do not believe that we have seen evidence that any of the proposed government solutions would improve the process. We are continuing to monitor this situation. But I believe at this point——

Senator DANFORTH. Well, I do not believe monitoring is much consolation. I hoped to ask you only two questions, and I was absolutely headed off at the pass.

The first question is, is it not true that the cable distributors themselves constitute a monopoly? To me, that is clearly true.

The second question I was going to ask you is why this should be an exceptional circumstance in which we should permit an unregulated monopoly to exist?

We did not get to the point one because you do not concede that it is a monopoly. But to me it is obviously a monopoly.

Senator GORE. Senator Pressler.

Senator PRESSLER. Mr. Chairman, most of the questions that I have are for the leading programmers, and I do request that we have a hearing with them here. And I think we should make time to do that.

Senator GORE. Senator Hollings and Senator Inouye will have to make that judgment in consultation with the ranking Republican Members, and I will certainly join you in making that request.

Senator PRESSLER. Good. In any event, I would like to ask one question of the members of this panel, and they are all experts in clear, concise English, or they would not be here.

There are many proposals before this committee. This committee could act on some legislation. Do you feel we should do nothing? Or what specific steps would you like to see us take legislatively?

And we could just start from left to right. Go ahead.

Mr. FINN. I think we have seen what doing nothing has caused in the marketplace. Sales are down 80 percent. There is a monopoly in the hardware. There are shortages in the hardware. It is almost as if we were that——

Senator PRESSLER. That is right. I mean, we know all the arguments. I am just asking, what do you want us to do?

Mr. FINN. Pass S. 889, the sooner the better.

Mr. CARP. At Turner Broadcasting, we would like to see Congress enact legislation along the lines of the Kastenmeier-Synar bill to free up these broadcast superstation distant signals for access to the backyard dish market.

That would create 10 or 15 additional programming sources that the Kastenmeier-Synar would be immediately available to packag-

ers. And we think it would have a profound constructive impact on this marketplace.

I must say that the Kastenmeier-Synar legislation is technically within the jurisdiction of the Judiciary Committee.

Mr. PHILLIPS. Senator, the satellite technology is a marvel in this modern world, and it opens the doors to a great benefit to rural America. And contrary to the witness next to me, VCRs and over-the-air broadcasts, and cable systems do not reach millions of Americans.

Senator PRESSLER. What legislation?

Mr. PHILLIPS. This legislation needs to be passed intact immediately. And in addition, legislation like the Kastenmeier bill needs to be enacted to clarify the copyright questions that now cloud the superstations and the network signals that also should be delivered to rural America.

Mr. PITSCH. I do not believe that the committee should enact this legislation. I believe that the Commission should continue to monitor the situation.

As you know, we have done a report. We have done an initial quarterly report. We are going to do two more of those reports. These are very careful analyses, and we plan on reporting back to Congress within a year, next February.

And I would not believe it would be prudent or in the public interest to enact legislation at this point.

Mr. WOLFORD. Press forward with S. 889 so that those 16 million second-class television citizens can be served without the heavy hand of cable and broadcast.

Mr. MOONEY. I think you ought to pass something like the Kastenmeier bill to clear up the copyright problem. And I also think you ought to have another hearing with the programmers, including one of the Robertsons, so they can explain to you in person why they scrambled their signal.

Mr. GROCHOSKI. We would support passing S. 889. And I would also agree with some of my colleagues here that the copyright issue needs to be addressed as well, in order to make the superstations legally available to the home dish market.

Mr. THOMSON. We think you should take a close look at the copyright issue, something along the lines of the Kastenmeier bill.

We also think you should jawbone the heck out of the programmers to give us more rights to market in other areas and to allow us access to the DBS authorization center. God knows we have not had much luck.

Senator PRESSLER. Thank you very much.

Senator GORE. Senator Wilson.

Senator WILSON. Thank you, Mr. Chairman. Mr. Phillips, Senator McCain was pursuing the validity of arguments in favor of third party packagers.

Now, let us assume for the sake of argument that the case can be made for them. Now, you represent rural coops. These coops were created by Federal largesse. They are still fairly substantially subsidized by Federal monies.

Let me just ask you, recently there was a rulemaking that granted to REA the authority to engage in some additional ventures, some new ventures.

But should Congress be concerned that subsidiaries of rural coops be limited to some extent in what they can do? In other words, do you think that cooperative subsidiaries should be able to operate movie theatres, amusement parks?

Mr. PHILLIPS. Probably not, Senator. The comparison that I would like to draw here is that for 52 years the rural coops have served a rural constituency, bringing new technologies, electric and telephone service, to them at a time when it was only available in the densely-populated cities.

Today, we are in the information age. There is a new marvelous technology available that is not available to the public in rural America. This is the information age, and this technology holds great promise for rural citizens.

We think that this satellite technology not only brings entertainment, but it brings information, education, and it brings applications that will coordinate very closely with our cooperatives' utility operation.

We have an addressable, communication link with the customer that we are now investigating for remote meter reading, remote home shopping, banking transactions, and other things that are running right along the line of our utility operation.

Senator WILSON. All right. Well, let me just ask you this then. There is no question about the historic role that they have played.

But what limits would you suggest Congress place upon their operation, so that they not be frankly put at a competitive advantage with the private sector?

Mr. PHILLIPS. Senator, the rural electric program is regulated by the Rural Electrification Administration. We have kept them informed of our progress in this venture. They have indicated to us that it is a worthwhile and proper goal.

They have cautioned us with respect to distancing ourselves with respect to the government funding. There is no government funding involved in the project that we are pursuing here.

And I think you already have a watchful eye on the progress that we are making in this regard. I think RCA will serve as a regulatory impediment, if you will, to any stepping over the bounds.

Senator WILSON. So your guidance to us then would be, separate any government funding and activity that would be directly competitive with the private sector?

Mr. PHILLIPS. That is really already the case, Senator, with respect to the way we are entering this marketplace. Yes.

I think you have a wonderful infrastructure here that has been built with the aid of the government. It has been very effective. It is proven. And I do not think we should be bashful about using it to bring new benefits to rural citizens. I think it is a great idea.

Senator WILSON. Mr. Mooney, let me ask you, I have heard the suggestion that the cable television industry, which controls several of the major premium service producers, opposes development of a strong home dish market.

I apologize I did not arrive early enough to hear your direct testimony, and you may want to comment on that in answering my question, and I would allow you to do so after you have answered the question.

But the reason that is supplied by those who make this argument is that a strong home TVRO market will lead to such improvement in delivery that ultimately it may lead away from cable altogether.

In other words, that R&D supported by revenue stream from dish sales will lead to technology advances, which may ultimately lead to everybody having a small dish in the home, and that there will be less and less expensive equipment that will mean much greater access directly to all kinds of services, thus making cable obsolete.

Do you want to comment on that?

Mr. MOONEY. Certainly. I do not believe in magic technologies. I think what people buy, in this instance, is the programming.

And they buy the customer service. They buy the diversity of viewing opportunities that pay television offers, as distinguished from broadcast television, conventional television.

And, you know, in 1979, when the FCC first delicensed earth stations for home use, the so-called backyard TVRO, we did not oppose that. Nor did we oppose two years ago the action of the FCC in pre-empting state and local governments from effectively using the zoning power to try to cut down on the proliferation of backyard earth stations.

We did not get into that. And my opinion is that the basic competition going on here is between pay television and free television. Sometimes that gets obscured, but I think the proper market here is television.

And to pay too much attention to competition going on between different distributors of pay television services, and incidentally there are more than just cable and TVROs, I think, is to miss the big picture.

And as to our own competitive situation, my feeling is that if we do a good job, we will survive and do well in the world. And if we do not, we will not. And, you know, you cannot really complain about that, frankly. And we do not seek to.

But this dispute, again, it seems to me, ought to be about whether people have access, and it ought to be about whether people have access at a reasonable price, which of course is the thing that gives meaning to access.

And in the absence of a serious demonstration of egregious abuse, I really do not think the government ought to be making laws identifying who ought to be distributors. I just do not think, with all respect for the many Members of this committee whom I have known for a long time, that the case has been made.

Senator WILSON. Mr. Finn, you seem eager to respond.

Mr. FINN. Thank you. I agree with Mr. Mooney on one point. And that is that I think that the marketplace is big enough for cable and for direct satellite to home communications.

I think the history of telecommunications shows that one new technology does not generally put another one, a more established one out of business. They just change their roles. It is big enough for both.

But as long as Mr. Mooney gave a little bit of a history lesson, I think we should also. Home satellite consumers and retailers could

have come up here and said, stop scrambling, we do not want to pay anything.

They did not say that. They did not resist fair payment, the way the cable industry did for 25 years, when they refused to pay copyright fees. Then Congress came along and said, we are going to legislate a copyright fee including a formula, a formula for cable rates included in the legislation.

S. 889 does not even go that far. It just says, a level playing field. It does not have the government setting rates the way the cable industry has the government setting rates in the copyright area and in the pole attachment area.

The last point is on the access question. I do not think that it is at all clear. I disagree with Mr. Mooney. It should be looked at. HBO announced early on that they were going to deny access to some of their KU band services. Now I understand they are thinking about that.

It seems to me they are in the business of providing service to consumers, and whether that consumer gets it over cable, over C band, or over KU band, should not make any difference.

Mr. PHILLIPS. Senator, may I make one point?

Senator GORE. If you can do it briefly.

Senator WILSON. Thank you, Mr. Chairman.

Mr. PHILLIPS. The only point I would like to make is that, with respect to offering programming, we see no reason for a satellite dish owner to pay more for programming than a cable company that is buying it for a customer receiving over it over a cable wire.

Anything different, without some explanation for a difference in cost justification is pure price discrimination. And I have testified to that.

Senator GORE. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. And Chairman Gore, I would say that, as an original co-sponsor of your bill, I think it is very basic and very important. There are 40,000 dish owners in West Virginia that are confronted, have made investments and are confronted with blank screens and unpredictability, changes in services from month to month.

And I do not think it is right, and I think this bill does much to redress it. I will agree that there have been some improvements from the point of the hearing of this nature last year.

But will they remain? Will it stay fair? Will programming costs be done on a fair basis, monopoly basis? I think there are a lot of questions that are still unsettled. And I think that the bill that you have put forward, Chairman Gore, will resolve many of those questions.

Now I have questions this morning only for Mr. Pitsch and Mr. Mooney. And to Mr. Pitsch I would ask this question.

Would you not say that the shortage of decoders, which in fact you have expressed some concern about, has kept the price of these electronic instruments artificially high?

Or at least, since there is only one supplier of them at the present time, it has kept a natural downward progression of price of those decoders from taking place?

Mr. PITSCH. Senator, I believe that both of those observations are probably true. I think that GIC did not anticipate the demand for decoders that we see today.

This could have been because there is uncertainty in the marketplace about the acceptance of scrambling among the two million dish owners. They have responded by increasing their capacity.

In March, for example, their capacity, their shipments were on the order of about 30,000 a month. Even in May, it was still only 33,000. But in June, that had increased to 40,000, in July it was 50,000.

They expect to have capacity on the order of 100,000 in September. They have licensed another manufacturer, Channel Master, to do modules only. That is the type of decoder that goes into the integrated receiver decoder.

And Channel Master will have capacity on the order of 30,000 modules a month, not that they will necessarily need all that, in December. So I believe——

Senator ROCKEFELLER. So what are you predicting? If there are two million dishes out there, about 200,000 people that have the decoders, and you are talking about potentially between 80,000 and 100,000 a month from the sole producer.

How long are talking before the decoders become available? Not to speak of the price at which they become available?

Mr. PITSCH. I would expect that, given the capacity of 100,000 a month, that the shortage that we see today would most likely disappear.

I do not believe that every dish owner will immediately want to buy a decoder. Many services, as the other witnesses have pointed out, are not scrambled. And only a few months ago, about six months ago, there was not a shortage.

I also think it is important to point out that the modules that will be coming on the market for the IRD units, will probably add on the order of about $170 to $180 to the satellite receiver. So you will see a dramatic reduction in the price for that reason.

The last point I would make is that there is a tradeoff between encouraging a company who innovates, who comes up with a unique and valuable idea, by giving it a patent and to earn higher prices than they otherwise would.

But, because of that system, we do encourage investment in the first place. And that does obviously benefit consumers as well. So I believe that what we see today is a result of that system, and I do not really make a comment on whether that is a good or bad thing.

Also I would add one final comment, and that is on the standard issue itself. I believe if we have a de facto standard already, and I think most people would agree we do, that we ought to allow competing manufacturers to try to invent around the existing patents.

They argued for that possibility in comments before us at the FCC in our inquiry. That might be the most beneficial way to bring competition in that market, the decoder market, to consumers.

Senator ROCKEFELLER. Mr. Mooney, in your testimony you talk about third party distribution requirements of the bill. It seems that you imply that the bill requires that all comers be allowed to sell programming.

However, the text of the bill merely says that the distributors may qualify if they "meet reasonable financial and character criteria. That sounds to me like it gives the programmer the ability to set the standard, but also prevents him from establishing a monopoly situation.

Now, my question to you is that there are a lot of very, very good retailers in this country. Sears, J.C. Penny, in West Virginia, Stone & Thomas, there are a lot of them.

Why should they not be able to get into this service also? Why should these services only be permitted as you appear to feel through cable operators?

Mr. MOONEY. I am glad you asked that, Senator. I know of no reason from the industry's point of view that they should not be able to get into this business.

And I want to make clear that nobody is suggesting that there should be anything structural here, which prevents the development of third party distributors. For all I know, they will develop.

Our problem with this bill is that, as we understand it, at bottom, it would apply Robinson Patman principles to this particular market. Robinson Patman normally has——

Senator ROCKEFELLER. Would you explain that to me, please?

Mr. MOONEY. Yes. The Robinson Patman Act was developed in the 1930's, primarily to protect small retailers against large ones.

I think the example most often given at the time was to protect the small mom and pop grocery store against the A&P. And I think for the time and place, Robinson Patman might have been appropriate then.

With respect, however, to this particular market, I personally believe it will develop best and to the greatest advantage of the consumer in a supermarket mode, whether you are going to have the programmers doing it themselves, or whether you are going to have third party distributors.

I think you are not doing the consumer a favor if you enact legislation—and I have to tell you I read the legislation this way, I could be wrong—if you enact legislation that puts a premium on a whole lot of very small distributors.

I think you are ultimately going to not realize the best price you can get from the consumer's point of view in that mode.

Senator ROCKEFELLER. But nevertheless, if you accept reasonable financial and character criteria, as what the law lays down, you do not object if others get into it? Other than cable systems?

Mr. MOONEY. We do not object to anybody getting into it. I mean, again, nobody in the cable industry is saying that there should be structural restrictions on who can be a distributor.

Instead we think the right question right now is whether there has been a pattern of behavior which disadvantages the consumer in such a way as to justify the imposition of government regulation and in particular Robinson Patman principles.

Senator ROCKEFELLER. My time is up, Chairman Gore. Mr. Finn wants to say something, I think.

Mr. FINN. Yes, I am interested that Mr. Mooney, who is president of the Cable Association, now claims to speak for the consumer. I think if the consumer looks at it, he really wants third party packaging. For one simple reason. And that is, the cable

folks and the programmers are so completely tied in together that there is no competition. We too have a chart, you can see the tie-ins.

HBO, Cinemax are both owned by Time, Inc. ATC is the second largest cable company. You can see the lines. Similar tie ins exist for other companies. This is just one little club. That is why third party packaging is necessary to bring some healthy competition.

Senator GORE. We are going to go into a second round so we can pursue this, if you like. But Mr. Mooney, you just said that you are not for any structural impediment to a third party distributor. And you said for all we know, it may develop.

Is there not a structural impediment if all of the major programmers refuse to negotiate or bargain with any third party distributor?

Mr. MOONEY. Respectfully, Senator, I do not think they have. We heard Mr. Phillips say just a little while ago that he had concluded distribution agreements with quite a number of the programming sources.

Senator GORE. Two.

Mr. MOONEY. Well, I think he has got——

Senator GORE. Two independent, CNN and CBN. None of the majors, the HBO, Showtime, et cetera. They have a policy of not dealing with any third party distributors.

Mr. Wolford, have you approached them all?

Mr. WOLFORD. I have approached them all. And I would sort of like to have you folks NRECA what they paid. Because I happen to know what I would pay if I had a 500-subscriber cable system.

I would like to hear. Was CBN going to charge you, NRECA, about 85 cents a head?

Mr. PHILLIPS. First of all, let me clarify something for the record. We do not have a contract in place with the Christian Broadcast Network.

I am not going to disclose the price that has been quoted to us. But I will state that it falls within the category that I quoted to the committee.

Senator GORE. Okay. Five hundred to 800 percent more than the price charged to cable company? That sounds pretty strange, does it not, Mr. Mooney? How do you explain that?

Mr. WOLFORD. Who does he have contracts in place with?

Senator GORE. I am going to let him respond first, and then. How do you explain 500 percent to 800 percent higher to a satellite distributed customer?

Mr. MOONEY. Prices for product of this kind are normally determined, not on a cost plus basis, but according to what the distributor or retailer thinks is the value that will be attributed to the service by the consumer.

I mean, books, for example, are priced that way. Movie theater tickets are priced that way. You pay a lot more for a movie ticket in the city of New York than you would in Kansas City. And that is only because the New York market will accommodate that, and the Kansas City market will not.

If you have a significant number of people taking advantage of the opportunity to buy something, then I think that, according at least to traditional pricing principles, that is the right price.

Senator GORE. The marketplace sets the right price, and if there is no competition, there is no marketplace. Or there is no market competition.

Mr. Phillips, who do you have contracts with, NRTC?

Mr. PHILLIPS. We have a signed contract with CNN Headline News, to offer their service. I have a contract from CBN. It is not signed because we are still contemplating the price and other terms.

I have a contract in place with some superstation signals that are with common carrier providers. I have a contract in place with several of the other minor programmers who have not yet scrambled their signals.

Senator GORE. Now, did you approach HBO?

Mr. PHILLIPS. We approached HBO and Showtime both.

Senator GORE. What was their response?

Mr. PHILLIPS. They are not interested in doing business with us on a wholesale relationship——

Senator GORE. Why not?

Mr. PHILLIPS. Senator, they want to control the market from New York. They want to authorize consumers from the 40th floor of their offices and they want to collect a complete price for programming and they do not want to have any distribution network.

Senator GORE. Now, both of those companies are owned by cable companies. Correct?

Mr. PHILLIPS. Yes, sir. I believe that is correct.

Senator GORE. And the cable industry faces competition from satellite dishes.

Mr. PHILLIPS. Absolutely.

Senator GORE. They have a self-interest in shutting off the source of supply to their technological competitor.

Mr. PHILLIPS. You are correct and we have absolutely no hope of concluding deals with them without some legislative assistance.

Senator GORE. Now, did you approach ESPN?

Mr. PHILLIPS. Yes, sir. And I announced this morning that verbally we have reached an agreement with them to offer their service.

They are the only programmer that has been willing to offer us a favored nations clause, which would make their price for the TVRO market comparable to the price to the home satellite dish owner and the cable subscriber.

But I would hasten to point out that they also have market area restrictions and other restrictions in the agreement, just as we have with CNN and other providers. So if it is not price, there are restrictive agreements in place.

Senator GORE. All right. Now, Mr. Grochoski and Mr. Wolford, you both have approached all of these programmers, and all of them have told you they will refuse to deal with you. Is that correct?

Mr. GROCHOSKI. We have approached all of those programmers on your list, yes, Senator. No, not every one of them has told us they will not deal with us.

HBO and Showtime have said that. Others have entered into negotiations, or what appear to be negotiations. They have in some instances dragged on for in excess of a year's time. And as I indi-

cated earlier, they conveniently find new reasons not to conclude a deal almost monthly.

Even though we will cave in to price demands and various other things, we can never get to signing a contract.

Senator GORE. Well, maybe they think Amway is not qualified to retail their service.

Mr. GROCHOSKI. If they think that, they have never raised it in any of our conversations, and I would hasten to point out that I think we are eminently qualified to retail their services, as we do things for many major companies in this country, including General Motors and Ford Motor Company.

Senator GORE. Well, of course, the question answers itself, because you have that demonstrated record. And NRTC, Mr. Wolford also have a record.

Now, I know you want to respond, Mr. Wolford, but let me come back to you on my next round. Senator Wilson.

Senator WILSON. Let me just ask the entire panel. You have already, with the exception of Mr. Pitsch and Mr. Mooney, indicated your support for the legislation.

Most of this discussion this morning, understandably, has focused on programming. The next panel has to do with the availability of the equipment. Is it your feeling that the passage of this legislation is going to solve all of your problems?

And I ask each of you that, and I particularly would ask Mr. Pitsch what his response will be if this is enacted, you are required to engage in activities that you are not now required to perform, and I gather are not eager to perform because you think that the marketplace will do it better.

Mr. Mooney, I would be particularly interested in hearing from you what you think will be the response on a broad front, not only of your clients.

But you have made a point that in contrast to the monopoly situation painted by Senator Danforth, that the proper way to view this is that television be provided by over-the-air, cable, or to the satellite dish owner as merely one form of entertainment.

That there are movies, VCRs, other technologies emerging to compete. I would be interested in what you see as the future for your industry. But let me just ask.

You said that you are in favor of it, and you have said why. Do you think that this legislation would solve all the problems, from the standpoint of the consumer and also the specific interest that you represent?

Mr. FINN. Senator, I think no piece of legislation solves all problems. All we want to do is to get a fair marketplace out there so consumers have options and have competitive choices which do not exist today.

I think in the decoder standard issue, that two points should be made. While I do not have great faith in the FCC, considering what they have done or more precisely what they have not done in this area, I do think that they have the ability to come up with some type of standard that is forward and backward compatible, so people do not get service disruptions.

And secondly, I think an important point would be to have a standard that other manufacturers can manufacture to so we get

some competition in the hardware side of the industry. So we definitely support that legislation.

Mr. CARP. Senator, CNN is now in roughly 40 million American homes. And our problem is to get into the other half of the American TV households that we do not now serve.

I do not know that there is a lot that legislation can do to solve our particular problem with respect to the home dish marketplace. What we would like to see in the short run is for Congress to enact something along the lines of the Kastenmeier-Synar bill.

That would make available 10 or 15 scrambled program services that right now either cannot be sold to backyard earth stations, or the legal ability to sell them to backyard earth stations is in enough doubt that people are afraid to do it. Or some people are afraid to do it.

We would like to see that legislation passed, clear that up. We think this would create more programming for people to sell, more people to sell programming, and that if Congress was going to do one thing, that is the one thing Congress should do soon to help this marketplace.

Senator WILSON. Are you saying, Mr. Carp, that you think that if that legislation were enacted, this would not be necessary?

Mr. CARP. Senator, we believe that if the Kastenmeier-Synar legislation were enacted, you would see a number of packages, and to the extent that that is the principal concern of this committee, I think that perhaps you would conclude that legislation was not necessary.

I think that when we see some packagers in operation, it will make some points that will be useful to the committee and to the industry. But without more scrambled programming to market, it is very hard to see how additional packagers are going to emerge.

Mr. PHILLIPS. Senator, I think it would be important to point out that much of the progress that we have made has been a direct result of the interests of Congress in this issue, hearings such as this.

I think that the bill would do a great deal toward resolving the problems in the market today. I also think that we need legislation to clarify the copyright question, which is a looming cloud over the industry's development.

I would like to point out as an example that we have become recently more comfortable with our relationship with the Turner network.

We have been able to sit down and work through some of the restrictions in the contract that I mentioned, and we are confident we will get those concluded soon. But we feel that it has been a direct result of some of the legislative efforts that have come forth.

Senator WILSON. Mr. Chairman, since there are just the two of us, would you have any objection if we go ahead?

Senator GORE. Sure.

Senator WILSON. Thank you.

Mr. PITSCH. Senator Wilson, we of course would comply with both the letter and spirit of the law, if it were enacted. And we would in any event continue to monitor this market, because I do think there are areas of concern that should be monitored.

I am not aware of any specific obligation in Senator Gore's bill for the FCC. I could be wrong. But I believe he does want the FTC to study the marketplace. But in any event, if there were any such obligation, we would pursue it.

On copyright, I would just mention in passing, since that has come up a number of times, as you are probably aware, the FCC has a notice of inquiry looking at broader copyright issues.

And pending that inquiry, the pleading cycle is not complete, I think the Commission would advise against enactment, or extension of compulsory licensing beyond where it is today.

Of course, if voluntary contracts were possible in the intervening time, they would obviously be desirable.

Mr. WOLFORD. Senator, I think that this legislation goes a long, long way in solving the problems and giving those 16 million people an opportunity to be served, that are never going to be served by cable.

In addition to that, one of the things that my economics professor at Long Beach State College jammed in my head is, he said the definition of a natural monopoly is when you have a sole source of supply serving a physical area, such as a gas company, the power company, the telephone company. That was before the days that cable was really big down there.

So we have deregulated them rate structure-wise. We cannot reregulate them. The best thing is to create competition. That is your level playing field.

I do not want Standard Oil owning all the gas stations in the United States. And I do not want cable owning all the distribution paths to the consumer, whether he is urban, suburban, or rural.

Mr. MOONEY. I think this could have serious disadvantageous consequences. The cable industry has built nearly everything there is to build.

And its incentive now is to increase penetration of homes passed. Nationally on average only about 57 percent of households which are able to take cable actually do so.

And if we are going to increase our penetration in those places, we are going to have to offer them some real incentive, something to buy. Something other than the free television they already can get off air.

That means programming. That is why you see so much vertical integration going on between the cable companies and the programming companies these days, because nobody has more incentive to put money into more and better programming than do the cable operators themselves.

This bill by imposing regulation on the distribution of programming, I think, could easily impede and discourage that kind of investment. Moreover, I think for the reasons stated by Senator McCain, that the reintroduction of the issue of a national standard for the technology would be catastrophic for the development of this business.

You have got a national standard. There is nothing else even remotely threatening on the horizon in terms of a different standard. I think to mess with it now would really be ill-advised.

Mr. GROCHOSKI. Passage of this legislation would certainly create a level playing field and enable competitive distribution of these

programming services to come into existence, all of which would, of course, benefit the American consumer.

It has been suggested that the copyright issue should also be looked at for purposes of assuring that the superstations can be delivered for home dish reception. And I would agree with that.

But I would point out that that in no way could be viewed as a substitute for this bill. This bill comes first and it is absolutely essential that it be passed.

Mr. THOMSON. As one of the packagers of programming for the home dish market, I have cited in my testimony five disadvantages or circumstances which are hurting, we believe, our sales.

Our belief is that none of these five problems would be solved by this legislation. Our belief is, with all due respect, that the legislation will spawn a substantial amount of litigation and tie the market up for years to come, the development of the market up for years to come. Consequently, we do not support it.

Senator WILSON. Thank you, gentlemen. Thank you, Mr. Chairman, for extending the time.

Senator GORE. Thank you. Indeed, I have a few more questions and then we will go to the next panel. Senator Wilson will also be afforded opportunity for more questions here, if he desires.

Mr. Mooney, you referred a moment ago to a representative package in illustrating the prices, and you said Showtime's package was a representative package. How many packages does it represent?

Mr. MOONEY. There are a number of packages out there being——

Senator GORE. To dish owners.

Mr. MOONEY. Offered by cable operators to dish owners.

Senator GORE. How many packages are offered to dish owners?

Mr. MOONEY. I cannot tell you that. There are very few others that are official cable operators. This is the primary example.

Senator GORE. One? How many offered on a nationwide basis? You said it was a representative package offered to dish owners.

I want to know how many there are offered nationally to dish owners as the Showtime package is. How many does it represent?

Mr. MOONEY. Senator, respectfully, I do not recall, and certainly did not intend to describe it as a representative package, carrying the inference that there are lots more like it.

Senator GORE. How many are there?

Mr. MOONEY. Well, United Video's got one consisting primarily, I believe, of broadcast signals. And there is this one.

You can also buy from HBO a package which includes CNN, and I may be anticipating their own announcement, ESPN.

Senator GORE. You are talking about one that is not available now? In other words, right now, a package that includes a premium service, there is only one. Right? There is only one.

Mr. MOONEY. No, sir.

Senator GORE. What other one is there?

Mr. MOONEY. HBO.

Senator GORE. Is that available now as a package with CNN? Okay, so there are just the two, HBO plus CNN. Do you get anything else in that package?

Mr. MOONEY. I think you are going to get ESPN in about a week. But all of the other basics that have scrambled thus far are owned by Viacom, which is——

Senator GORE. Well, I wanted to clear that up, because some people may have inadvertently gotten the misimpression that it was a representative package. It is not. It is one of arguably two that are available.

Now, is it common for programmers allowing cable operators to distribute their signal to restrict them to their own cable franchise area, and not allow them to sell outside of their franchise area? Is that common?

Mr. MOONEY. For cable distribution?

Senator GORE. No, for distribution to home satellites.

Mr. MOONEY. I understand that it is. Yes.

Senator GORE. Why?

Mr. MOONEY. I think the programmers as a group prefer to see how this market develops before they make any firm——

Senator GORE. Before they allow any real competition.

Mr. MOONEY. Commitment to cable operators to sell outside their service areas.

Senator GORE. Well, I mean, are they afraid that even if they keep it tightly controlled to the cable systems, they are a little afraid that two of the cable systems might start competing with each other.

And so they say they can only distribute within fixed geographical areas, and there can be no competition between two cable companies. Correct?

Mr. MOONEY. And I think, Senator, that as some of the programmers testified here last year, they are reserving the option at the moment, at least in the instance of the pay services, to be in that business themselves.

They want to be first party distributors. They do not seem to be all that interested in having the cable operators——

Senator GORE. No, no. But I want you to answer the question on the rationale for preventing cable distributors from competing with each other.

Now, where you have a cable company distributing to cable customers, there is an obvious reason why that cable company is only going to serve the franchised area. It has been given a franchise.

The cable only extends in a certain geographic area. And so that cable company does not face any competition for his or her cable customers.

Now, if that same cable company gets the right to distribute a program to satellite dish owners, why should that cable company not be allowed to go across the road and sell it to others?

Mr. MOONEY. There are a lot of cable companies, including some of the majors who are asking that question, and I think that the fact that the programmers have resisted that importuning as strongly as they have just demonstrates that this not a matter of some kind of a conspiracy going on between the cable operators and the programmers, but that the programmers are calling their own shots.

Senator GORE. Well, they are calling, the industry is calling the shots. That is for sure.

But why will they not allow two cable companies to compete with each other? Why the restriction preventing a cable company distributing to satellite dish owners from distributing outside their franchise area? Why?

Mr. MOONEY. I think the programmers prefer to do it themselves.

Senator GORE. No, no. They are allowing a cable company to distribute it. There are examples of where they will allow a cable company to distribute the program.

Oh, you mean they allow, they prefer to do it themselves outside the cable's, so they do not want the competition from the cable company.

Mr. MOONEY. They figure they are already in competition with other programmers. As do HBO and Showtime.

Senator GORE. But they do not want competition from any other distributor?

Mr. MOONEY. At the moment, they appear to think that they can best serve this market by being primary distributors themselves outside of cable franchise area.

Senator GORE. All right. And it is your view that HBO and Showtime are fiercely competing for these satellite dish customers. Right?

Mr. MOONEY. Senator, it is my impression that Showtime and HBO are fierce competitors in every form and——

Senator GORE. What percent of the market is penetrated by HBO and Showtime? Among satellite dish owners? There are two million of them.

Mr. MOONEY. I suspect about 10 percent.

Senator GORE. About 10 percent? Well, that fierce competition is not spreading very far. Is it?

Mr. MOONEY. There are other pay services which are still unscrambled. I suspect that as they scramble, you will see more people subscribing to HBO and Showtime.

Senator GORE. Well, now, last year——

Mr. MOONEY. The rate, in any event, of subscriptions is picking up very fast to both of those services.

Senator GORE. Well, the point I am making, and Mr. Pitsch may not like this particular economic analysis, you are fond of economic analysis generally, but market penetration is commonly recognized as one measure to look at.

If only 10 percent of the market is being penetrated, 90 percent of the people are not being served. And the supply and demand lines are not crossing at a point reflecting the efficiency of the marketplace.

Now, another example. Last year, we had a lot of discussion of this $5 a month kickback fee, that HBO and Showtime had agreed to pay the nearest cable company every time they signed up a customer for their direct satellite dish service.

Now, the industry was embarrassed by the hearing last year. They were embarrassed particularly by the kickback discussion. And immediately after the hearing, they eliminated the kickback, the $5 market, I forget the gobbledy-guk phrase that they used instead of kickback.

But they eliminated that $5 a month payment to the cable company for every satellite dish customer that they served. Correct?

Mr. MOONEY. That is right, Senator. The only rebate I know of now that is still being paid is to dish dealers.

Senator GORE. All right. Now, you had HBO and Showtime, each with a $5 a month charge that they were paying to the nearest cable system. Now, they are politically embarrassed, and they remove that $5 a month charge.

Did the price to the satellite dish owner immediately come down $5 a month? The cost of delivery was reduced $5 a month. Did it come down $5 a month?

Mr. MOONEY. The prices for both services have come down substantially, although certainly not by $5 per month.

Senator GORE. Please answer the question, Mr. Mooney. You and I know each other well, and let us not dance around too much on this.

Mr. MOONEY. I have not——

Senator GORE. Let us not dance around too much on this. The fact is they took the $5 kickback out of the picture and the price stayed the same.

Mr. MOONEY. Oh, no, sir.

Senator GORE. There was a very, very slow, gradual, downward trend. But essentially the price stayed the same. My point is this.

If there was fierce competition between HBO and Showtime, and all of a sudden for political reasons they both have to get rid of this $5 a month kickback, then you would see that competition drive the, all of a sudden they are able to deliver it for $5 a month less.

If they are fiercely competing, they are going to take advantage of that, and they are going to grab some of their competitor's market. They are going to serve more people. Maybe extend into the market more than 10 percent.

But instead, they stayed exactly where they were. They did not compete. They did not take advantage of that opportunity to compete. Mr. Finn, have I misstated the facts here?

Mr. FINN. I agree with you totally, sir.

Senator GORE. Mr. Mooney, now have a response. Go ahead.

Mr. MOONEY. Senator, you put me in an odd position. It is very difficult for someone who does for a living what I do to flatly disagree with a statement made by a Member of the Senate.

But I think, sir, it is not true to say that that price has remained exactly the same. I think that even the people here today who have testified have said that the price of the pay services has come down significantly.

Senator GORE. I have said it has come down gradually. I am talking about the day before the kickback was removed, compared to the day after the kickback was removed. There was no change.

Mr. MOONEY. Senator, the kickback, which was called a brand utilization discount by the program——

Senator GORE. That is it. I could not remember.

Mr. MOONEY. Which is the same term as is applied to similar payments made by wholesalers in a number of other industries, was removed primarily I think to give reassurance to Members of this committee and other Members of Congress who have expressed concern about this, that the cable industry, and particularly its programmers, were bending over backward to avoid even the appearance of impropriety.

But you know, I guess perhaps this issue has become so emotional that there seems little that we can do that will be taken as evidence of good faith and a genuine attempt to deal decently with this problem.

Senator GORE. Well, you could allow competition, and you could deal with the third party distributors. And that would be fine.

Do not get me wrong. I am glad that you removed the kickback. I think that was politically embarrassing for you, and I think it was the clearest of what I believe were several anti-trust, probable anti-trust violations going on here. And I am glad you removed it.

The point I am making is that when it was removed, if there was a competitive marketplace, you would have seen the disappearance of that $5 a month per customer cost reflected in the competition that allegedly is taking place. And it was not.

There was a letter that was reported from a Mr. Daniels, and I think Mr. Finn referred to this in his testimony. It is Daniels & Associates, a multi-system operator in the cable industry, owned by Bill Daniels, the 22nd largest multi-system operator in the country.

And according to press reports, there was a letter June 15th from Mr. Daniels to Jules Haimovitz, president of Viacom, which is the parent of Showtime, et cetera, complaining that Viacom was beginning to lower its price.

And the quote from the letter is, he is complaining that the Showtime/Movie Channel's working philosophy is not in sink with their statement that it is not their intention to compete with their primary distributors.

Asked how a reader of the letter could conclude that it represented anything other than another example of an MSO trying to put pressure on a programmer, who is aggressively trying to serve the home dish owner. Maglio said reading the letter alone would provide insufficient information on Daniels' policies because it would be taken out of context.

Are you familiar with this letter?

Mr. MOONEY. Yes, sir. I have even gone to the trouble of obtaining a copy of it and I can give it to you for your record, if you would like.

[The following information was subsequently received for the record:]

DANIELS
&ASSOCIATES INC

Gerard A. Magrio

June 15, 1987

Jules Haimovitz
President
Showtime/The Movie Channel
1633 Broadway - 37th Floor
New York, NY 10019

Dear Jules:

Our meeting in Las Vegas seems like it occurred years ago as so much keeps happening so quickly in this business. I'm sorry I didn't get back to you sooner with our promised response but I am pleased to offer to it to you now in the hopes that it might help forge better relationships, and more business to share between our companies.

I've enclosed Alan McDonald's summary report to me which probably will suffer some inaccuracies due to the fact that your group's efforts are constantly evolving and changing over time. Please understand that the spirit with which it was written was an attempt to help your organization recognize some of the areas it was posing difficulties for operators and, to create an improved situation for all of us to prosper within.

I'd also like to share two observations with you that Alan didn't mention in his report and which I find particularly troublesome. First, we believe that both VSN and the cable industry would be better served if you allowed cable operators to sell Showtime/The Movie Channel in non-cabled areas in close proximity to their existing wired cable franchises. We believe this will result in additional promotion and sales for Showtime/The Movie Channel while it will, to a large measure assuage much of Congresses' dissatisfaction directed at both of our industries. As you know, both the House and Senate are scheduled to hold hearings in July on these issues. We believe it is paramount for both of our industries to do all we can to diffuse the issue of "limited distribution." Allowing cable operators to be your distributor/sales agent in "white and grey areas" would go a long way towards putting these inquiries to rest once and for all. As they say, the devil you know is better the devil Congress may require you to know.

Secondly, The Showtime/Movie Channel organization is well represented by an excellent field sales marketing and affiliate relations group. I personally believe that they should be given the responsibility of representing Viewer's Choice and HTVRO as well. Right now, we have to deal with three separate entities when attempting to do business with your organization. This serves to undermine the efforts of your regional group to provide comprehensive service to us and causes a lack of understanding within your organization of the big picture as it relates to your relationship with Daniels & Associates.

My recommendation would be for you to consider allowing the regional office staff to represent you on all your product lines. They would certainly have access to your expert resources in HTVRO and pay-per-view, but would be the central point for us to work with and would have optimal knowledge of the situation with Daniels in general, as well as specifically with all of your individual product lines.

We've been asked to provide a copy of this letter to your Denver regional office but have decided to let you effect that distribution if you desire. Thanks very much for sharing your thoughts with us at the show, and for giving us the opportunity to provide this input to you.

Best wishes,

Gerard A. Magrio

DANIELS &ASSOCIATES INC.

MEMO

TO: Jerry Maglio

FROM: Alan McDonald

SUBJECT: Showtime's "Cable-Unfriendly" HTVRO

DATE: June 12, 1987

As a follow-up to our meeting with Showtime in Las Vegas, I am listing our concerns regarding Viacom Satellite Network's policies and procedures as you requested.

During our meeting, Jules mentioned that it was not his intent to have Viacom's Satellite Networks undercut his primary distributor, cable operators. We are not sure however if that policy has filtered down to those charged with the responsibility of developing the new DBS revenue stream. The working philosophy of VSN was eluded to in their recent newsletter..."available now to HTVRO subscribers at prices which are lower than typical cable retail prices."

The VSN staff is charged with growing the DBS business. The more HTVRO customers the better. They believe that they will be judged by how many DBS subs they have acquired, rather than how many DBS subs they have obtained from outside cabled areas. As the quote above indicates, the VSN staff thinks that growth, no matter what the source, is good. The VSN staff believes that undercutting cable operators DBS programming prices will result in more TVRO direct customers for Viacom. They're most likely right.

You may recall that several SHO/TMC representatives indicated that VSN customer service representatives refer potential customers calling from within cabled areas back to the local cable company. That may have been the intent, but it certainly was not the case yesterday nor is it today. Yesterday, three calls were made to the VSN authorization center and none were referred back to the local cable company. We called three times more this morning and none of these calls were referred back to the local cable system either. On two occasions when the callers inquired as to whether or not it would be better to purchase the service from the local cable operator, both callers were told no because they wouldn't be able to buy Viewer's Choice pay-per-view movies from the cable operator. Two other customer service representatives told the callers that VSN offered a better package and the other two callers were told that they could call the cable company if they wanted to but that the Showtime/TMC package was most likely better than that offered by the local cable company. All callers were reminded that the 12-channel basic service package would be free through the end of 1987 and two of the callers were told that the local cable company would not provide those services for free.

Our guess is that you'll find Jules' policy of not competing against his primary distributor is not shared by the VSN staff. I suggest that you ask Jules, himself, to blind-call the VSN staff to inquire about signing up for its services. (Remembering to make sure to indicate an address from a cabled community. The number is 1-800-845-3131.)

By the way, three calls to HBO were all referred back to the local cable operator.

If it is VSN's goal to maximize HTVRO subscriptions, we would have expected to have received some information, encouragement, and promotional literature from them. Neither our systems nor anyone at the corporate office has been called on by VSN staff members. The majority of the literature we have received regarding VSN has been forwarded to us from our own cable systems and not from VSN. The majority of the calls and letters requesting information, clarifications, and assistance to the VSN staff have gone unanswered. The Denver regional office has done their best to assist us, but in the end, the lack of communication by VSN can only be construed as the lack of desire to work with cable operators as a middleman. We think it odd that their "primary distributor" is kept in the dark while VSN distributes a monthly newsletter to TVRO dealers. Again, it may not be their intention to have VSN undercut Showtime's primary distributor, but I can't help conclude that it is VSN's goal to do exactly that.

Further indications that it is VSN's intention to aggressively pursue all dish owner subscriptions is manifested in the programming package they have put together. Showtime/TMC are enhancing their appeal to dish owners by selling scrambled basic services at the wholesale price, the same price the basic service programmers charge cable operators. Obviously, we can't sell basic programming services at retail prices when VSN distributes them at wholesale prices. A quick review of this packaging and pricing policy will reveal that VSN's philosophy is not in sync with their statement that it is not their intention to compete with primary distributors.

The VSN procedures which we find cumbersome and irksome are listed below. However, it must be noted that we believe the new revised procedures address only a very small portion of our concerns. We believe the original procedures were made intentionally cumbersome to delay, for as long as possible, a cable system/operator's authorization to act as a SHO/TMC satellite distributor. After all, the longer a cable operator was precluded from distributing SHO/TMC to dish owners, the more cream would be skimmed by VSN. When you compare VSN's procedures with those of other satellite programmers, it becomes readily apparent how unnecessary the majority of the procedures are.

A. "If a Cable Affiliate so qualifies for the Program, the Cable Affiliate will have the right to sell Showtime and TMC to HTVRO owners in accordance with this licensing policy and procedures."

That would be fine if VSN adhered to its own policy. Our system located in Sonora, California was denied status as an authorized distributor by VSN's legal counsel. The problem was straightened out by their Denver regional office, but of concern to us is the unilateral decision by a person in charge of drawing up the agreements to abrogate the agreement.

B. "This rate card is subject to change by Showtime/The Movie Channel, Inc. in its sole discretion upon thirty (30) days' notice."

That's fine, however the rate card was changed without any notice being forwarded to this office or to our cable systems. Right off the bat, there are two instances in which VSN didn't comply with its own contractual obligations.

C. While on the subject of rate cards, why does there have to be a separate TVRO rate card at all? We have 55,000 Showtime subs working off one rate card and a handful of TVRO subs working off another rate card. The two rate cards significantly complicate our accounting and billing procedures as well as their procedures and auditing chores. Why not require us to pay the same license fee for all of our subscribers?

All of us are aware of the attention focused on TVRO programming rates by the TVRO industry and congress. We agree with the consensus that dish owners should pay less than subscribers served by cable plant. It is difficult, however, because their HTVRO license fee is higher than the cable license fee. When a cable operator bills an HTVRO subscriber for Showtime/TMC, we assume the billing expense. The cost to us is approximately 35¢-50¢ per month, which is about the same differential between the two rate cards, the cable rate card and the HTVRO rate card. Why not therefore, make the rate cards uniform. Also, it would seem appropriate to standardize the rate cards in light of the fact that the Marketing Development Allowances have now been discontinued.

D. The Cable Affiliate is required to notify Showtime in writing of any change in TVRO subscriber status. Why? It is redundant and totally unnecessary. We will call and tell them to deauthorize the VideoCipher. That's all that is necessary. Note that no other programmer has such a requirement.

E. "TVRO subscribers must notify in writing both Showtime and the cable company of a change of address within 30 days of the change." Again, we believe this is a totally unnecessary requirement. If we send a bill to an old address and a subscriber does not receive and subsequently pay it, the VideoCipher will be deauthorized for non-payment.

F. "Showtime/TMC and (cable TV company) reserve the right to use customer names and addresses for other marketing opportunities subject to applicable law."

Absolutely not. TVRO owners purchasing services from our systems are our customers and their viewers. The fact that we are required to provide their names and addresses to them security purposes does not entitle them to directly market other "opportunities" to dish owners. No such rights accrue to them for our 75,000 other subscribers. Why do they require it of HTVRO viewers?

Direct solicitation of our TVRO subscribers by VSN and subscriber confidentiality were the subject of several phone conversations I had with Steve Schulte in May of 1986. Subsequently a memo outlining our views on the subject along with suggested remedies were forwarded to Steve. The language that we asked VSN to agree to was:

"Under no circumstances will Showtime/The Movie Channel, Inc. or any of its subsidiaries, affiliates, or agents solicit subscriptions for Showtime, and/or The Movie Channel for a package of programming services by direct contact with cable television subscribers and Showtime and/or The Movie Channel subscribers receiving Showtime and/or The Movie Channel directly by means of a TVRO system."

Simply put, we asked that they agree not to solicit our customers which were already purchasing Showtime/TMC. They refused to agree to the language or propose alternative wording. We believe their refusal to alter this operating procedures is indicative of their policy to....."grow the business any way you can."

G. "In the event a Cable Affiliate or its HTVRO subscribers do not conform in the judgement of Showtime/TMC...may at its discretion at any time and without notice:

Terminate a Cable Affiliate's Showtime and/or The Movie Channel Agreement."

The VSN staff and the Showtime/TMC staff have always maintained that VSN was a separate business distinct and apart from Showtime/TMC. Why now does VSN require that they be joined together in their Affiliate Agreement?

Although it seems as if the tail is wagging the dog on this issue, we can agree, if the right to terminate cable/HTVRO Agreements is reciprocal. Our systems should have the right to discontinue Showtime/The Movie Channel carriage if, in the future, as in the past, VSN violates its own policies and procedures.

H. Geographic Boundaries: The HTVRO Affiliation Certificate, Exhibit B of the Licensing Policy and Procedures, requires a cable system to supply geographic boundaries of the "energized feeder cable." In light of the revised registration requirements allowing cable systems to sell to TVRO owners within their entire franchised area, this requirement becomes an unnecessary, make-work task and one with which we cannot realistically comply.

Cable systems are not built from North Street to South Street to East Street to West Street. There are jigs and jags at every feeder termination. Cable plant cuts across farmers' fields and, as is noted in the recent submittal to VSN by Foothills Cable, one of the boundaries is "a cliff."

Given that the revised policies grant us the right to sell within our entire franchise area, why not let it rest at that. It must be remembered that most cable systems continue to add new plant every year which means that the energized plant boundaries we give them today will be obsolete next month or perhaps next week or tomorrow. One of our systems reported that it took at least 24 manhours to complete the registration forms. The same system is budgeted to build in excess of 25 miles of new plant extensions this year.
Not only is VSN's data base becoming more inaccurate day-by-day, VSN has provided no mechanism to update its data base. If they plan on asking us to provide new boundaries every year, it will only result in more wasted time. The requirement that we provide geographic boundaries of our cable systems results in a time consuming bureaucratic process which provides VSN with soon to be obsolete data for input to its data base.

Senator GORE. Yes, we would like to have it for the record. If somebody could get that. Is this in fact an example, yet another example of market intimidation?

They have negotiations coming, either under way or coming up of the cable affiliate agreement with Showtime and movie channel. Do they not?

Mr. MOONEY. Sir, I do not think, to answer your question, that it is a question at all of market intimidation.

The reason I went out and got the letter was because the article in *Satellite Times* was almost all analysis and very little quote. And I decided that I had to see for myself what it said because I knew that you and others would be interested in it.

This thing is basically two things. It is a long litany of complaints about the logistical arrangements that Showtime has made for selling to the TVRO market through cable distributors.

It also contains I guess something of a complaint, according to the following lines. Daniels says that it has a distribution agreement for TVRO subscribers in its areas for Showtime, and that it looks around and finds Showtime selling the same product in the same place for less than Daniels can sell it for.

In other words, you have a retailer who sees that his own wholesaler is selling the same thing in the same place for less than the retailer himself can sell it for. And this, I submit, is not an unusual sort of complaint for a retailer to make to a wholesaler.

You would find that whether it was potato chips or anything else. I think the real point to be drawn from this, however, is that Showtime does not seem to have paid any attention to that complaint and is out vigorously marketing the service itself.

And you have again evidence here, hard evidence that what is going on in this market is not some kind of a conspiracy or collusion between cable operators and programmers. That the programmers are calling their own shots and that they have not been put up to whatever they have been doing, as some people have alleged, by the cable operators.

Senator GORE. The text of the letter is indeed interesting. It says, as you know, both the House and Senate are scheduled to hold hearings in July on these issues. We believe it is paramount for both of our industries, cable and programming, I would insert there, to do all we can to diffuse the issue of limited distribution.

Skipping to the last sentence on that page, as they say the devil you know is better than the devil Congress may require you to know.

Mr. MOONEY. What he is saying, he would like to distribute the service outside, he is saying he would like to distribute the service outside of his franchise area.

Senator GORE. I am going to conclude my questioning on this round. But I would like to ask others to comment, if they wish. Mr. Finn, I saw you asking for a chance.

Mr. FINN. Senator, I have just one quick comment. Mr. Mooney is saying that the cable industry, the MSOs, are not placing pressure on the programmers with respect to their policies.

We have a gentleman right next to me who is with Turner Broadcasting. As soon as Turner Broadcasting was taken over by

TCI and the other MSOs, virtually at the exact same time, the exact same time, Turner got out of the packaging business.

And I know this gentleman was not there at the time, or at least I do not think he was, but I would like to know whether the reason that they got out had anything whatsoever to do with TCI or the other on MSOs——

Senator GORE. Well, we are going to avoid having one witness ask another witness a question. But I am interested in that question.

So you go ahead and respond.

Mr. CARP. This witness is happy to respond. I think all of you who have followed the fortunes of Turner Broadcasting know that for most of the last nine months, Ted Turner has been out seeking additional financing for his company.

And that he has been holding discussions with a number of parties, including people from the motion picture industry, including people from the cable industry.

Those negotiations which led to the cable operator investment in Turner Broadcasting went on over a period of months. During that period of months in which these negotiations were going on, this package was thought up, discussed, and dropped.

If Turner Broadcasting had been primarily interested in the motivations of these potential cable investors, I am sure the package never would have surfaced.

Senator GORE. Was it dropped immediately after TCI's purchase?

Mr. CARP. It was dropped several months after the formal announcement, and after notification to the Justice Department, the SEC, that the deal was going to go through.

It was dropped coincidentally around the time that the formal agreements were entered into, but not at the time that the deal was agreed to. In fact, it was announced at around the time the deal was agreed to.

The truth of the matter is——

Senator GORE. But not finalized.

Mr. CARP. No. It was finalized. This whole episode basically took place while government approvals were being sought for this purchase.

Now the truth of the matter is that the Turner package consisted of around 10 broadcast signals, which would be marketed, and around three cable services.

We looked at the condition of the copyright law, and concluded that it is not prudent for a company in Turner's position, especially not a company that operates a superstation itself, to be in the business of marketing broadcast signals.

We were then left with only three things to sell. CBN, CNN, and Headline News. As a matter of fact, if you will call right now, 1-800-VIEW-CNN, you can purchase all three of those services. I mean, we are continuing to do what it is we can do under the law as it exists.

Senator GORE. All right. Senator Exon.

Senator EXON. Mr. Chairman, thank you very much. I am going to be very brief because I want to move along.

Let me see if I can put this in some kind of perspective, gentlemen. Sometimes I think when we get into our rights and our non-

rights and all of these kinds of things, I think most of you on this panel know where this Senator comes from.

I have no ill will towards any of you. I think you are all, for the most part, independent, honest businesspeople that are trying to do a job.

Sometimes I think maybe in our efforts to do the right thing, both from the standpoint of the regulators, which we are here as the oversight committee with deep responsibilities in this area, we forget maybe sometimes what the history of this is all about and why there are those of us who represent not profit-making companies, and God bless them, I am for them. But we represent the people who enjoy the services.

Now, historically, as you well know, I just want to get this in the record, Mr. Chairman, the broadcasting industry was a heavily-controlled industry. There were only so many frequencies that could be assigned, both on radio broadcasting and television broadcasting.

So out of that, and you are all familiar with that, out of that has grown deregulation. Now, before deregulation took over, do you remember the big argument that we had a long time before I was involved in public office, but when television suddenly went from black and white to the grand brand new media of color television.

And there was a big debate at that time those who had control and had brought forth color television, you know, they wanted to make it exclusive. The Congress finally settled that by mandating simulcasting.

You could not put anything on television unless it could be in black and white or in color. You know, that is not exact on point here. But over the years the people have come to expect that what is in the airwaves is there's if they have the mechanism to tune in and listen to it.

Now comes cable, and of course cable in my opinion has done a tremendous job. I happen to watch Turner Broadcasting more than I watch anything else, because I love news and I love baseball.

And as I have said many times, usually I do not watch anything unless it has news in it or a ball.

Now, I am not a typical listener. But you have done a great job. So I think there are those of us here who recognize, and let me go one step further.

In my home in Lincoln, Nebraska, I am a first-class citizen. I have cable television. I live here in Montgomery County, which is supposed to be the highest income county in the world, I guess.

I cannot get cable television. Supposed to get it sometime within the next year. I miss it. And I think cable has done an outstanding job.

What we are trying to tell you cable operators is we got problems. The rights of the people who have traditionally tuned in have been affected, many times in good ways from the services that you provide.

But there is a relatively small segment out there today of our total population that are getting stepped on. And I recognize you have your rights and your program rights and the artist's rights and the proprietary interest that you have for the expensive programming that you do. We are not trying to take that away from you.

What I am saying, and I am only preaching to you once again, ladies and gentlemen, that I think there must be a way to solve this problem if we work constructively together and I for one have been keenly disappointed.

I remember well more than a year ago, we had a hearing not unlike this, Mr. Chairman. And we were assured then that this whole problem was going to be solved because there would be scrambling and there would be a relatively inexpensive scrambling device that could be purchased by those who hold and own dishes.

And that seemed like a reasonable proposition to me and I have gone along with it. The fact of the matter is a year later we are no further along to solving that problem than we are. And I wish this legislation were not necessary.

But I think this legislation is necessary unless we can move much faster than we have in the last two years to solve this problem that confronts a relatively few people in America, but a very important people.

And they are entitled to the same opportunities as others as best we can give it. Thank you, Mr. Chairman.

Senator GORE. Thank you very much. Senator Wilson, before we go to the next panel, did you have other——

Senator WILSON. Just one, Mr. Chairman. And I hate to delay going to the next panel, and these gentlemen have been before us for some time.

But let me just come back to Mr. Pitsch, because evidently I did not make myself clear. The bill, as I understand it, does require of the Commission that you be the one that sets a standard for scrambling and for decoding.

If this bill is enacted and you are required to do that, do you feel competent to do it?

Mr. PITSCH. Senator, you are right. I was wrong. I had forgotten that the bill does require us to select a standard.

And I think that from what I have already said it should be clear that there are questions as to whether or not that would be beneficial because the benefits of having a uniform standard seem to have been achieved already.

Of the 38 satellite cable services that have announced that they intend to scramble, they have all picked the VC II standard.

And it seems likely to be the case that no one, given that kind of concentration, that kind of embedded base in the market among the existing dish holders, will go to another standard capriciously.

They will have some reason, and likely they will go only if in fact it is compatible. Because that is very important. It makes economic sense to be able to serve those people.

So, my concern would be that if we were required to pick a standard, that we would create some uncertainty in the decoder market, and we might very well preclude the evolution of the standard, technical improvements, the possibility for competition, because they have a legitimate patent today.

And it may be the case that Oak and others might be able to develop a competing, compatible decoder. And regulation, a standard, might be used to delay that kind of competition and innovation.

It has happened often, because the regulatory process does afford people that kind of opportunity. So I would have serious concerns

about it. And while I am not going to say emphatically that all of those bad things would necessarily happen, I think the potential for costs outweigh the expected benefits.

Mr. WOLFORD. Could I add a comment to that, Senator Wilson?

Senator WILSON. If the Chairman will permit it.

Senator GORE. Surely.

Mr. WOLFORD. In 1954, the television industry came to the FCC and said, we have a compatible, color system that works on both color TV sets and black and white TV sets. It was de facto standard, so to speak.

And the FCC adopted it. And because of that we have had forward compatibility, where that two-inch 1940 TV set still works. Why can the FCC not come forth and make that the standard?

Senator EXON. Mr. Chairman?

Senator GORE. Senator Exon.

Senator EXON. The comments that were just made follow up to the point, I think, that I made in my comments earlier.

I would like to ask you, Mr. Pitsch, am I wrong in assuming that the technical means of simulcasting in television for both black and white and color was probably much more of a mechanical, technical, technological problem than descramblers of signals, so long as we would mandate that those signals be scrambled in some sort of a uniform way?

I guess my question is, If the government could mandate that there be simulcasting on both black and white and color television, it would not be out of line, and it certainly would not be as much of a technical problem, would it, for the government to take the same action with regard to scramblers and descramblers?

Mr. PITSCH. Senator Exon, I am not myself technically competent to compare. I suspect you are right, that the television questions are more complicated and involve a lot of tradeoffs.

Indeed, because of our recent efforts in the advanced television area, I learned, for example, that some of the lack of clarity and resolution that we have in color today involves, reflects the fact that we required that kind of compatibility. And so there were tradeoffs involved.

What I am saying today, though, is that given we have a de facto standard, that is that all of the satellite cable program services are going to use the VC II system.

Then if you involve regulation in setting the technical standards, you run the risk of us drawing a line which might seem reasonable would allow certain kinds of compatible activities, but might preclude others.

And there are always going to be tradeoffs. There are no solutions. There will only be tradeoffs in this kind of a situation.

And I would argue that given the competition, given the potential for innovation, the commenters certainly supported it, members in industry, who might be competing manufacturers, that it would behoove us to not go down that route, because while the dish people are going to have the benefit of one decoder, we might run the risk of precluding innovation.

Senator EXON. Thank you, Mr. Pitsch. Thank you, Mr. Chairman.

Senator GORE. Well, thank you. Mr. Finn, very briefly.

Mr. FINN. Just a quick point. I do not think it is quite correct that the only standard out there is the VideoCipher II.

Sony has a standard that is being used for some pay-for-view services. There is Telease and a Bemac system by Scientific Atlanta. So there are a number of different technologies out there.

I think the reservations that Mr. Pitsch has in getting involved in this, people understand. But I think when you balance those theoretical possible problems against what has happened in the last year, in the last two, the disaster that has happened to this industry, and the continuing monopoly, I think you have got to come down strongly on the side of the legislation. Thank you.

Senator GORE.Without objection we will hold the record open for statements from Showtime and HBO and other programmers who wish to provide input for this hearing.

I want to again emphasize that the fight for satellite TV viewing rights is not between local cable operators and dish owners.

Many local cable operators, certainly many in Tennessee, want to serve dish owners with competitive packages, just like the noncable distributors with us today do, and indeed TCI has testified today that it would like the opportunity to serve outside its franchise area.

The fight is between the millions of home dish owners and businesses and the MSO/programmer stranglehold on programming delivery. We will pursue the issue with the next panel on the decoder.

But we are going to combine the next panel, the next two panels in light of the time. But before doing so let me thank all of our witnesses on this first panel. It has been a very long morning into the afternoon. We appreciate your patience and your presence here. Thank you.

I would like to ask our next witnesses to come forward. If we could make this transition more quietly. We are going to combine the last two panels.

Mr. Larry Dunham, executive vice president and general manager of the VideoCipher Division with General Instrument Corporation, Mr. Charles Ergen, president of Echosphere in Colorado, Mr. Michael Hobbs, senior vice president for policy and planning with the Public Broadcasting Service, Mr. Raymond Timothy, group executive vice president with NBC, and Ms. Diane Davis, Route 2, Box 278, St. Joe, Arkansas.

If the five of you could come to the witness table, please proceed. If we could make the transition a little more quietly please.

Senator WILSON. Mr. Chairman, while we are waiting for the witnesses to get settled at the table, in the interest of clarifying the record, I am advised that the Disney channel has no connection with a cable operator. And apparently at some point there was either a statement or suggestion that they do.

Also, I am advised that that chart that was over there on the right suggested that the Disney channel is not available to TVRO owners, and I am advised that it is.

Senator GORE. No, I did not say it was not available to, I said it was not available to third party packagers, third party distributors. That is the meaning of that chart.

And I thought that we clarified that Disney was not owned by a cable company. In fact, I do not see where it was so identified. If it was, it was in error. But the chart that shows cable ownership of leading program services does not include Disney. But in any event, it is clarified. We appreciate it.

All right, we will wait until you get set up there. All right, very good. We have combined the last two panels, as I noted. But we would still like to go through the witnesses' statements before taking questions, unless Members of the subcommittee wish to interject a particularly important question.

First, let me also add that as with the first panel your entire prepared statements will be included in the record. So we will have the opportunity of everything that you want to deliver to the subcommittee.

But we would ask you to confine your oral presentations to three minutes. And then we will get through all five witnesses and then turn to questions.

We will begin with Mr. Larry Dunham, who is executive vice president and general manager of the VideoCipher Division of General Instrument Corporation in San Diego. Mr. Dunham, welcome, and please proceed.

Senator WILSON. Mr. Chairman, before Mr. Dunham proceeds, I was just wondering whether you and I and Mr. Exon were going to be rewarded for our diligence by being allowed to keep the samples that have been brought here.

Senator GORE. I think the answer to that question is no.

Senator WILSON. Probably in violation of the Ethics Committee.

Senator EXON. I would be glad to accept any of those that you want to give us, so long as they do not cost more than $100 under our regulation, and so long as I understand they are made in the United States of America.

STATEMENT OF LARRY DUNHAM, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, VIDEOCIPHER DIVISION, GENERAL INSTRUMENT CORP.

Mr. DUNHAM. Senator, if I might comment. I would like to be able to answer that question after the hearing today.

Senator GORE. Well, we are getting out of hand here. Please bear in mind that a joke is a joke. Now, go ahead, Mr. Dunham.

Senator WILSON. I am sorry I brought it up, Mr. Chairman.

Mr. DUNHAM. Mr. Chairman and Members of the committee, it was almost a month to the day that I was across town here at the House hearing talking about these same matters.

And it was a very intense afternoon for me and one that I still remember very keenly. I sat next to Ms. Fontineau, who is a distributor from Louisiana. Next to her was a Mr. Kozian from Ohio.

And I listened to their testimony. Mr. Kozian is a dealer in Ohio who is struggling to keep his dealership alive. He has had difficulty in getting VideoCiphers over the last few months.

And that has created real problems for him because with the turn in demand for descramblers, it has become very difficult for him to sell a satellite system without a descrambler.

Ms. Fontineau testified that she was having great difficulty in getting VideoCiphers, necessary to move her other products, and stated that she had only gotten 68 in the last few months

Unfortunately, her facts were very close to reality. That is the real issue as far as the VideoCipher product is concerned today, availability of product. It is one that I am acutely aware of.

After the hearing here in Washington, I went to my home in Alabama, where I spent time with my family. And I found out that my brother there, who installs dishes, has not been able to install a dish for two months due to the shortage of descramblers.

As a matter of fact, his distributor is Ms. Fontineau. So this issue is extremely close to me, and it has affected me personally. I feel it every day.

The fact of the matter is that we have done everything possible between the resources of General Instrument and the resources of Channel Master to ramp up the capacity for descramblers and to supply the demand that arose very suddenly over the last four to five months.

Mr. Ergen, who is here testifying today as a distributor, was one of the few that has had acess to large quantities of descramblers. In the month of March, as an example, he received 9,000 VideoCiphers.

And that was one of the issues that Ms. Fontineau brought up, and is one that has been debated very hotly and one that I am very aware of. As we get into the questioning, I would like to expand on that a bit more.

The other issue that faces the VideoCipher Division is that the standard FCC mandated clause in the legislation is one that we do not feel is necessary.

The Division in San Diego and myself personally have spent the last four and a half years working with the programmers and the manufacturers in the industry. We have licensed an alternative source to manufacture the descrambler.

We forward priced our product, based upon very large volume projections, going into the future. We think that we have done everything possible to handle the moral responsibility of being the standard.

We have licensed competitive sources. We have 16 manufacturers today, you can see some of their products here in front of us, that are selling product with VideoCipher included in it.

We do not think that the FCC establishing a standard is necessary, because the marketplace has chosen us as a standard, and is evidenced by over $300 million of investment, by the cable programmers, the cable operators, and the consumer.

There are over 210,000 consumers that have units installed, and that are receiving programming today. We do not think the legisation is necessary.

[The statement and questions follow:]

STATEMENT OF J. LAWRENCE DUNHAM, GENERAL INSTRUMENT CORP.

Mister Chairman and members of the subcommittee, my name is J. Lawrence Dunham and I am Executive Vice President and General Manager of the VideoCipher Division of General Instrument Corporation. I want to thank you for this opportunity to appear before you and describe our recent activities in the field of

satellite television encryption. I welcome this chance to provide you with up-to-date information, which this hearing will also help disseminate throughout the TVRO industry—to manufacturers, distributors, programmers, dealers and consumers.

In addition, I want you to know that we oppose S. 889 because the standards requirement would result in marketplace uncertainty and confusion.

General Instrument Corporation ("GIC") is a manufacturer and supplier of electronic products, systems and components. GIC is the industry leader in cable TV electronics, coaxial cable and satellite encryption systems. The company's primary strategies are directed toward communications systems. The common stock is listed on the New York, Midwest, Pacific and London stock exchanges.

On September 19, 1986, GIC acquired the Cable/Home Communications Corp. from M/A-COM, Inc. Included as part of this acquisition were the facilities, equipment and inventory of M/A-COM's Video Products Division. In addition, a great many of the former M/A-COM employees, including myself, who were an integral part of the Video Products Division, have joined GIC as employees. The Video Products Division had the responsibility to develop, manufacture and market the line of VideoCipher® video scrambling products. The Video Products Division has now been renamed the VideoCipher Division.

In my testimony today, I want to concentrate on events that took place after GI's acquisition, but I also want to provide a historical perspective for the subcommittee's record. Even though some of this material may have been covered in hearings held in the previous Congress, I believe that it will be beneficial to have a complete record for consideration in this Congress.

In my testimony, I want to describe the structure of the backyard dish marketplace. Next is an historical perspective of backyard dish scrambling. Then I will cover two matters of current interest, descrambler availability and piracy. Finally, I want to bring to your attention a problem imposed by the U.S. Government, a prohibition on the export of consumer descramblers. First, however, I want to make it perfectly clear why we oppose S. 889.

S. 889 Requirement for Standards Would Freeze the Technology and Disrupt the Marketplace

We oppose S. 889, because it would interfere with the working of the marketplace. In particular, we oppose the legislative requirement for the FCC to adopt a single standard for satellite television scrambling. There is no need for an FCC-mandated standard because all satellite TV programmers have already agreed on a single standard—the VideoCipher® II system. A mandatory standard would freeze the technology and prohibit us from making improvements in the system. Moreover, during any FCC proceeding to adopt standards, we would be required to publicly disclose a great deal of technical information about the VideoCipher® II system that we now keep confidential because we fear that public disclosure could compromise the security of the system.

Most seriously, we believe that there are elements that would use an FCC proceeding to stimulate consumer uncertainty and confusion. They would tell consumers that the FCC will reject the VideoCipher® II standard. They would tell the FCC that, contrary to fact, the VideoCipher® II system is too limited in capacity, reliability or technical performance to be chosen as the standard. They would use the FCC proceeding as a forum to disseminate misinformation. As a result, this market will become less stable, and consumers will suffer.

The Satellite Television Market

The satellite television marketplace is extremely complex, perhaps more complex than any other discrete marketplace within the telecommunications industry. Here is a list of the most important players in the satellite television marketplace:

program producers (e.g., Hollywood studios)
program packagers/syndicators (e.g., HBO, Showtime)
cable TV operators
cable TV subscribers
home TV receive-only earth station (HTVRO) manufacturers
HTVRO wholesalers/distributors
HTVRO retailers
HTVRO owners
TV set manufacturers
commercial TV networks
trade associations (e.g., NCTA, SBCA)
domestic satellite owners/operators
Federal Communications Commission
Congress of the United States

When the Congress passed the 1984 cable TV legislation, some members of Congress felt that the public interest would be best served if satellite cable TV programmers would provide service to the owners of HTVRO earth stations. Scrambling was clearly contemplated as the way to protect access to the signals and assure compensation to the producers and distributors of programming. My point in listing these players is to show that there are many competing interests, and that it was a slow and difficult task to reach the marketplace agreements that were necessary to let satellite television scrambling proceed. However, it is now going forward, and it is proceeding in a manner that does serve the public interest.

As you will see, the marketplace is moving forward. Programmers are scrambling their programming, consumers are purchasing descramblers in increasing numbers, subscription prices are coming down, and a new generation of integrated receiver/descramblers is on the market resulting in effectively lowered equipment costs for the consumer. There have been a few rocky episodes along the way, exactly what is to be expected from a new business just starting up.

Historical Review

To describe where we are today, it is necessary to review the development of the satellite television distribution industry over the last decade. Starting in the 1970s, Home Box Office and other program syndicators began distributing movies and other entertainment to CATV systems using point-to-point terrestrial microwave. This use of point-to-point microwave relays gave complete control over access to the signals.

Later in the 1970s, HBO took the lead in the industry because it was the first to recognize that domestic satellites could be used to distribute television to a wider range of CATV affiliates at a lower cost than terrestrial microwave. In the 1970s, receive-only earth stations cost upwards of $100,000, so that economic considerations resulted in nearly the same degree of control over access to the signal as had been the case with point-to-point- microwave. The earth stations were simply too expensive to be owned by large numbers of consumers.

In the early 1980s, however, the trend to lower cost earth stations was becoming clear. As satellites were launched with higher power and the receiver technology matured, thousands and then tens of thousands of earth stations were sold to commercial establishments and private consumers.

It was at this point that HBO and other satellite programmers became concerned about limiting access to their signals, particularly with respect to the commercial establishments. Part of the reason that the programmers began to focus on this matter is that the motion picture industry and its primary trade association, the MPAA, began putting pressure on the programmers to assure protection of the copyrighted material. Some of these programmers felt that their signals were protected from unauthorized private viewing by Section 605 of the Communications Act, since they were not using the satellites to "broadcast" but rather to distribute their signals to discrete locations. However, they also felt that it would be difficult, expensive and perhaps politically impossible to try to enforce the protection of intellectual property rights guaranteed by Section 605 with respect to private HTVRO owners.

Consequently, to a large extent the interest in satellite television scrambling was an economically-driven technological alternative to court enforcement of intellectual property rights. I want to stress the influence of economics in the decision processes, because economics has continued to play a very influential role as the scrambling system design evolved.

In 1982, HBO became the first satellite television programmer to move in the direction of television scrambling by releasing a Request for Proposals for a television scrambling system. M/A-COM and other telecommunications equipment manufacturers responded to this competitive RFP, and M/A-COM won the competition. The winning design included digital encryption of the audio, very secure digital processing of the video signal, and an array of administrative features that were necessary for the commercial aspects of the system. Among the administrative features were the ability to directly address and authorize individual descramblers. This system is now known as VideoCipher® I.

However, during 1983, as we went from the design stage to the prototype and preproduction stage, it became clear that the VideoCipher® I design was too expensive for delivery to a consumer market in the 1985 time frame, because of the extensive digital processing of the video signal. This made it unacceptable to HBO, because HBO's goal was to serve the consumer market and VideoCipher® I was too expensive for that market.

Consequently, M/A-COM redesigned the system so that it could be produced at substantially lower cost. This new system design, now known as VideoCipher® II, retains the digital encryption of the audio but substitutes a somewhat less secure but lower cost analog scrambling technique for the video.

In addition, during this period the administrative capabilities were enhanced so that competing program suppliers could use our system and the consumer would only need to buy a single descrambler. We felt, and we continue to feel, that this is an important feature of our system. We do not believe that the public interest would be served by the adoption of several incompatible scrambling techniques that would require consumers to buy several different pieces of hardware if they wanted to subscribe to several different program suppliers. We did not want a situation to arise that was similar to the VHS-Beta incompatibility in the video recorder market, so we designed our system to accommodate all programmers that wanted to scramble their signals. In this way, competition between programmers will occur in this programming marketplace, and it will not be distorted by limitation designed into the hardware.

By March of 1984, the VideoCipher® II system design was virtually completed, and in October we released the preliminary interface specifications, first to HBO and then to HTVRO manufacturers. Since the descrambler must be connected between the indoor HTVRO receiver and the TV set, it was important both for the HTVRO manufacturers to understand the electrical specifications of our descrambler and for us to understand the electrical specifications of their receivers.

We had hoped that the receiver manufacturers would supply us with information about their units, but when this did not occur we went out to retailers and purchased them. Between M/A-COM and HBO, we purchased and tested over thirty different HTVRO receivers to test for compatibility. Our initial design goal was to make our descramble compatible with over fifty percent of the HTVRO receivers on the market. Later, at the programmers' urging, we changed this goal to ninety percent compatibility and we revised our design accordingly. These design revisions resulted in a decoder that was somewhat more expensive, but the public interest gains from increased compatibility outweigh the increased cost.

Throughout 1984, we were continuing to discuss television scrambling with other satellite television programmers, but no other programmers were will to make a commitment to scrambler at that time. Moreover, several of our competitors were actively marketing television scrambling systems that were incompatible with our design.

Finally, in November 1984 we signed a contract to provide scrambling and descrambling equipment to Showtime/The Movie Channel. This decision was the next important step that eventually led to adoption of VideoCipher® II as the de facto industry standard. However, our competitors continued to try to market their systems to the undecided programmers. The majority of the programmers held back on their decision to scramble and choice of a scrambling system until the second half of 1985.

In October 1984, we began delivery of the uplink scrambling equipment to HBO and by March 1985 we had completed delivery of cable headend descramblers to the cable TV systems that were affiliates of HBO. HBO began testing the system gradually, initially scrambling a few hours of programming per week. By late 1985, as much as half of the HBO programming was being scrambled on a test basis.

During this testing program, we carefully monitored the reliability of the descramblers. By October 1985, over 46 million operational hours had been logged, with a mean time between failures of over 93 thousand hours, or about ten years. These descramblers are highly reliable, and the consumer descramblers are similarly reliable because much of the circuitry is identical.

Meanwhile, our efforts to work cooperatively with the HTVRO manufacturers continued. In March 1985, we hosted a meeting of over thirty HTVRO manufacturers where we explained the VideoCipher® II system in great detail. We spent time describing the interface specifications for the VideoCipher® II descrambler that is intended to retrofit existing HTVRO installations.

We also described in detail the specifications of the VideoCipher® II circuit module that is designed to fit into the next generation of HTVRO receivers. The next generation of HTVRO receivers, the integrated receiver/descrambler which is now available, incorporates the VideoCipher® II circuitry as a plug-in module comparable to a videotape cartridge. This has resulted in lower total cost to consumers and higher reliability.

Under the terms of our contracts with HBO and Showtime, we are committed to distribute our VideoCipher® II technology as widely as possible and make it available in modular form to fit into the HTVRO receivers made by other manufactur-

ers. We are committed to making the technology widely available. Another aspect of our contracts requires us to license second-source manufacturers of the descrambler modules. Channel Master is now licensed as a second source.

During 1985, several additional events of note occurred. In May, we announced plans to operate the computer center that we now call the DBS Authorization Center for the system on a nonprofit basis. This computer center receives the subscriber authorization information from each programmer, merges the information into a single data stream, and returns that data stream to each programmer. In this way, a subscriber needs only to tune to any of the scrambled channels in order to be authorized to watch all that he has subscribed to. Since the different program channels all carry the same authorization information, an authorized descrambler will receive its status messages no matter which scrambled channel is being watched. Consequently, subscribers can switch between independently-operated program services without loss of descrambler authorization.

This is a key public interest point that needs additional explanation. The system could have been designed so that each video signal would carry its own authorization information, but only its own. In this case, a subscriber would have to tune to each signal sometime during the month in order to receive the authorization for the next month. It is possible to conceive of a situation where a viewer finds nothing of interest on a particular program service during some particular month, so never tunes to that service and never receives the authorization information for the next month. If this were to occur, the viewer would be inconvenienced by having to make a telephone call to the programmer to have a special authorization message sent. Our system design avoids that inconvenience.

Also in May of 1985, HBO announced that it would use the services of the DBS Authorization Center. Our system is designed so that a programmer could, if it wished, operate its own authorization computer center separately from other programmers. However, our view that consumers would be best served by the operation of a single authorization center in which all programmers participate. All of the programmers that are serving the HVTRO market and have decided to scramble with the VideoCipher® II system have chosen also to participate in the single DBS Authorization Center. That computer has been up and operating since January, 1986, at our facility in San Diego.

In the summer of 1985, we announced that we were ready to accept orders for consumer descramblers from wholesalers, distributors and HTVRO manufacturers. The initial order came from Channel Master, which is marketing a private labled version of the descrambler.

Also in the summer of 1985, RCA endorsed the VideoCipher® II system. RCA's decision was largely based on the direct compatibility of VideoCipher® II with the 150 million TV sets now in American homes. VideoCipher® II uses a signal format based on the NTSC format. NTSC stands for National Television Standards Committee; this is the industry committee that proposed the current TV format many years ago. In making this endorsement, RCA rejected the alternative scrambling system based on a MAC (Multiplex Analog Components) format.

During the September and October time frame, a large number of programmers made decisions to scramble using the VideoCipher® II system. First, Showtime announced firm plans to begin offering scrambled programming to HVTRO owners. Showtime also announced that it would participate in the use of the DBS Authorization Center.

Then, Turner Broadcasting—Cable News Network and CNN Headline News announced plans to scramble and use the DBS Authorization Center. Since then, most of the other programmers—Disney, MTV, VH1, Nickelodeon, USA Network, ESPN and several new pay-per-view operators—also announced plans to scramble, using VideoCipher® II technology and the DBS Authorization Center in San Diego.

On January 15, 1986, HBO began scrambling all of its satellite feeds full time. Then, on May 27, 1986, Showtime/The Movie Channel began full-time scrambling. This event was accompanied by a press conference organized by SPACE, the Satellite Television Industry Association, to underscore the availability of diverse satellite programming and demonstrate the easy operation of the scrambling system.

Later in 1986, SPACE merged with the Direct Broadcast Satellite Association to become the Satellite Broadcasting and Communications Association. The Satellite Broadcasting and Communications Association (SBCA) has been established as the single trade association representing the satellite broadcasting industry. Chuck Hewitt, formerly Executive Vice President of SPACE, is the President of SBCA. SBCA members include all of the major backyard dish and electronic manufacturers, satellite manufacturers and operators, the program suppliers, and many of the equipment distributors and retailers. One benefit has been to provide a forum in

which issues of concern to the industry, such as programming, equipment supply and video piracy, can be addressed.

Turner Broadcasting began full-time scrambling of Cable News Network and CNN Headlines News on July 1. Other programmers began scrambling in August, October, November, and December of 1986, and January, March and May of 1987.

In August of 1986, at the request of the Congress, the Federal Communications Commission jointly with the National Telecommunications and Information Administration began a study to determine whether government intervention might be needed in the home satellite broadcasting industry. In a report issued in early 1987, they decided that there is no need for intervention at this time. They found that the marketplace has settled on a single scrambling standard, the VideoCipher® II system. They also found that program distribution mechanisms are developing in a competitive way, with discounted program packages developing and pricing comparable to cable TV pricing. The FCC decided to continue monitoring the development of this industry through 1987, and to provide the Congress with a final report at the end of 1987. In a quarterly report issued July 16, 1987, the FCC affirmed the conclusion that no direct government intervention is needed in this marketplace.

In summary, the VideoCipher® II system has been chosen by over 40 programmers to secure their satellite feeds. Programmers that are now rolling out their scrambling include Disney, MTV and ESPN. As of the end of July, some 161,000 commercial descramblers have been shipped to cable TV and SMATV affiliates. About 205,000 consumer descramblers have been authorized at the DBS Authorization Center. Some 287,000 consumer stand-alone descramblers have been manufactured and shipped, and another 87,000 modules have been delivered to integrated receiver/descrambler manufacturers. Fifteen receiver manufacturers have been licensed by the company to produce integrated receiver/descramblers that incorporate the VideoCipher® II module, and we anticipate that others will soon be licensed. The past year has been one of growth and success for this program.

Piracy and Illegal Decoders

The security of the VideoCipher® II system is based primarily on the digital coding of the audio channels. The two audio channels are transmitted as digital data which is encrypted using the Data Encryption Standard (DES) algorithm. The video is also scrambled, using an analog approach.

The security of DES is based on a 56-bit "key" which is like a password. In a properly designed system, a DES-encrypted message cannot be decrypted unless the key is known or unless all 72 quadrillion possible keys are tested by trial and error. Each descrambler has a unique secret DES key contained in a secure microprocessor. To descramble a particular transmission, the descrambler must have the DES key used to scramble that program at the uplink. The program key is transmitted over the control channel to each authorized descrambler, after first encrypting it with that descrambler's unique key. Only the intended descrambler will be able to decrypt the program key and obtain the program.

A number of illegally modified VideoCipher® II descramblers were placed in use by consumers and dealers in late 1986 and early 1987. Some units had been modified by replacing the proper integrated circuit with a slightly modified integrated circuit that allowed a dish owner to receive more signals than he or she actually paid for. Other units were modified by copying the address code from a unit that was legally paying for service.

I want to stress that these modifications did not attack the security design of the system or the DES algorithm itself, but rather the management of the program key within the descrambler. I also want to stress that it is not correct to say, as some have said, that the VideoCipher® II system has been "compromised." There was a temporary breach of security, but we have an ongoing comprehensive program to assure the integrity of the system.

Some of these modifications may have been made by consumers themselves. We know that some of these modifications were made by third parties who then sold the illegal descramblers to consumers.

General Instrument Corporation has responded to this in several ways.

On December 3, 1986, at a press conference in Anaheim, California, a consumer alert was announced warning the public about so-called "pirate" descramblers. The company warned the public to avoid purchasing these units because (1) it is illegal to own one, and (2) the company would soon implement security measures to deactivate these units. A news release with this information was distributed to the wire services and the consumer satellite TV guides.

The firmware coding of the circuitry and the physical mounting of the components have been modified in the manufacture of VideoCipher® II decoders since late 1986, to prevent similar tampering in the future.

Legal actions have been instituted against manufacturers, marketers and promoters of these illegal chips.

Specific descrambler addresses of modified descramblers were obtained when U.S. Marshals executed seizure orders at the premises of one of these manufacturers and promoters. Last week a preliminary injunction was issued against some of these defendants who have been promoting unauthorized interception through "off-shore" conferences and satellite broadcasting. We understand that a number of government officials, including prosecutors, Customs officials, the FCC and the Royal Canadian Mounted Police are continuing to pursue video pirates. When asked, we cooperate with them.

In the first wave of electronic countermeasures beginning February 13, more than 6,000 descramblers were deactivated. Most of the illegally-modified units were blacked out or received specific messages when we instituted electronic countermeasures.

We instituted an amnesty program from February 15 to March 15, where we agreed to repair, for free, any illegally-modified descramblers that were sent to us. Using our electronic control, we sent messages announcing this amnesty program that were displayed on the screen only if the decoder had been modified. The amnesty announcement was distributed to the wire services, via satellite-delivered video news release to television stations and advertised in the consumer satellite TV guides.

In interviews with the press on and after February 16, General Instrument Corporation publicly warned consumers against fraudulent and illegal schemes to avoid paying subscription fees to programmers. We specifically announced that "amnesty represents our final effort to protect consumers from the consequences of owning and using an illegal descrambler" and that "the consumer has only a one-time, four-week change to qualify for amnesty."

On March 3, during the SBCA satellite TV national convention, we handed out thousands of leaflets describing the amnesty program. We briefed the press on the legal actions that had been instituted, and on the progress of the amnesty program.

Analysis of the first wave of the countermeasures program show that it was 99.96 percent accurate in shutting off targeted illegal decoders.

In a second wave of electronic countermeasures beginning in May, an additional 6,000 illegal decoders were shut down. At that time, GIC stressed that the countermeasures program is ongoing, and that owners of illegal decoders that have not yet been shut down can expect to see their decoders as targets of the program eventually.

Some consumers claimed that they purchased illegally-modified descramblers without knowing that they were modified. While not impossible, this is highly unlikely. The scrambling program has received widespread publicity in the TVRO community, particularly concerning the suggested retail price of legitimate descramblers, the monthly subscription fees of programmers, and the authorization procedures required for "turning on" legitimate descramblers.

Regrettably, there has also been considerable publicity, carried over satellite channels, about alleged devices to "beat the scrambling system" and avoid payment of subscription fees to the programmers. We continue to think it unlikely that a consumer was unaware of this publicity and unknowingly purchased a modified descrambler.

Nevertheless, if any consumer can establish to our satisfaction that he or she is in fact the innocent purchaser of an illegally modified descrambler and is willing to help locate and prosecute the party who defrauded him, we are prepared to repair the descrambler at no charge.

Manufacturing and Supply of Descramblers

We are committed to distributing the VideoCipher® II descramblers as widely as possible. We ship units to about 30 distributors and wholesalers, who serve 5 to 7 thousand retail dealers. We have shipped consumer descramblers to several hundred cable television operators around the country. We are shipping private label units to Channel Master, and later this year we expect to start shipping private label units to Houston Tracker, both of which have their own channels of distribution.

The demand for consumer descramblers has increased substantially in recent months, as more programming services began scrambling and as marketplace uncertainty and confusion has decreased.

As of the end of July, some 287,000 consumer stand-alone descramblers and 87,000 descrambler modules have been shipped. Some 30,000 were shipped during March and another 30,000 during April and during May. We increased this to 40,000 in June and 50,000 in July. There are some 205,000 consumer descramblers authorized as of the end of July, and authorizations have been running at the rate of about 15–20,000 per month.

In recognition of these increasing levels of demand, we have taken a number of steps to ensure that an adequate supply of descramblers is available in the marketplace.

In April, the company committed $1 million in capital improvements to the Puerto Rico manufacturing facility, and also committed several million dollars to purchase long lead-time parts and components for VideoCipher® II units.

In May, we announced that we plan to invest an additional $4 million to expand production capacity. This investment will give us a manufacturing capacity of about 100,000 descramblers per month by the end of September, and as much as 130,000 per month by early 1988.

Over the last several months, Channel Master has been manufacturing and supplying us with 10,000 descrambling modules per month. As I mentioned previously, Channel Master is licensed as a second source manufacturer.

In May, we announced that Channel Master would increase its manufacturing capacity and would soon begin direct sales of descrambler modules to other manufacturers for incorporation in integrated receiver/descramblers. Channel Master is committed to supply us with 12,000 modules per month, and this program of direct sales would apply to modules beyond that number.

Based on current authorization levels and our models of the marketplace, our current optimistic projection is that there will be approximately one-half million consumer descramblers in distribution by September. We believe that these steps I have outlined will provide adequate capacity to meet the expected demand for descramblers.

Initially, the VideoCipher® II descramblers were available only as separate units of equipment that attach to home TVRO receivers, with a suggested retail price of $395. Within the last few months, the descrambler has become available as a module on a single circuit board that is integrated into home TVRO receivers.

Fifteen manufacturers are licensed at this time to incorporate these modules into their home TVRO receivers, and several have already designed and introduced home TVRO receivers that have this feature. These integrated receivers, with the decoding module installed, cost less today than a TVRO receiver without decoding capability cost several years ago.

As the market has evolved, demand for consumer descramblers has increased. Until we developed a mathematical model of the marketplace, however, our production levels were determined almost entirely by the orders we received for descramblers and descrambler modules, from distributors and receiver manufacturers. Upon receipt of an order, we ordered parts and components, and then manufactured the products. The normal lead time for delivery, from the time we received an order, has been about 120 days, which is typical in the consumer electronics industry. Those distributors and manufacturers that placed orders with us earlier this year have been receiving their deliveries on schedule. Some distributors and manufacturers, who did not place advance orders, have not been able to get adequate supplies in a time frame they consider to be reasonable. By ramping up our production levels, we will be taking on more of the risk by committing to build descramblers prior to receiving orders, but we are willing to take that risk in order to assure adequate supplies.

Prohibition on Export of Consumer Descramblers

We are facing a problem caused by U.S. Government export control policies, and I want to describe that problem to you.

We are not permitted to export the VideoCipher® II consumer descramblers.

We want to be able to export the descramblers because there is a demand for them from Latin America and the Caribbean. U.S. domestic satellites that carry cable programming have coverage patterns than include these areas, and there are thousands of backyard dishes in Mexico, Latin America and the Caribbean island.

The U.S. Government considers all scrambling and descrambling units to be "defense articles" covered by Category 13b of the International Traffic in Arms Regulation (22 C.F.R. 121). Export of such items requires an export license issued by the State Department, but the State Department seeks advice from the Defense Department on the national security aspects of defense article exports. Exports of these products to Canada are exempt from the ITAR licensing requirements.

The National Security Agency is the element of the Defense Department that has jurisdiction over scrambling technology. NSA has decided that export of scrambling/descrambling technology that incorporates the Data Encryption Standard is contrary to the national security, except in a few limited circumstances. Because of this policy, NSA has told us that they will not permit us to export the VideoCipher® II consumer descramblers.

However, they feel that export of the VideoCiper® II commercial descrambler is a different matter. We have been granted export licenses to ship VideoCipher® II commercial descramblers to cable TV and SVATV affiliates in the Caribbean and Latin America.

The consumer units and the commercial units both contain DES technology. In NSA's view, the difference is that the cable TV or SMATV operator is a business affiliate of the programmer, while the consumer is not.

Now, frankly, we would like to be allowed to export consumer descramblers. If we were allowed to export consumer descramblers to the thousands of backyard dish owners in Mexico and the Caribbean, it would have a positive impact on the U.S. balance of trade. In addition, there are cultural benefits that come from exporting our programming to backyard dish owners outside the U.S.

Moreover, we have strong technical reasons for our position that export of the consumer descramblers would not compromise national security. For example, the few uplink scramblers are all within the continental United States, and access to the uplinks is tightly controlled in every case. The descramblers are useless without the scramblers at the uplinks.

We also believe that the NSA position is unrealistic. While our shipping documents state very clearly that the descramblers cannot be exported without a valid export license, this alone is unlikely to stop a consumer from carrying a unit out of the country. These descramblers are consumer products, widely available over-the counter at retail stores, and small enough to fit into a suitcase. The U.S. Customs Service has an impossible job in trying to stop consumers from smuggling these units out of the country.

The Congress is now dealing with trade legislation that would amend the Export Administration Act to make it easier for U.S. companies to export their products. However, the Export Administration Act applies only to non-defense items regulated by the Commerce Department, so these legislative changes will not help our product.

I would welcome any help the Congress could give us in dealing with this matter.

Conclusion

General Instrument Corporation is committed to making the satellite TV business a success. We have invested a great deal of resources and money in this industry, and it is a very important part of our plan for the future.

The scrambling of satellite TV programming is now a reality. Over forty programmers have chosen the VideoCipher® II system to scramble their satellite signals. Consumers need to purchase only one descrambler, because the VideoCipher® II system is the industry standard. Consequently, there is no need for legislation nor FCC proceedings to choose a standard.

The next generation of home TVRO receivers has become available, integrating the descrambler module directly into the receiver. The result is lower cost and higher reliability for the consumer.

The industry has matured in the past year, with the help of its trade association, the Satellite Broadcast and Communications Association. Manufacturers, dealers, distributors and programmers have all benefited from the efforts of the SBCA.

The industry has a bright future and I expect continued growth.

I appreciate the opportunity to appear before you today, and I would be happy to answer any questions you might have.

GENERAL INSTRUMENT

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August 21, 1987

The Honorable Ernest F. Hollings
Chairman, Committee on Commerce, Science
& Transportation
United States Senate
Washington, D. C. 20510

Dear Chairman Hollings:

I am writing in response to your letter of August 3, 1987, in which you conveyed an additional question to me for the purpose of completing the record of your hearing on July 31, 1987, on the scrambling of satellite video signals. The Committee Staff was kind enough to allow me a few additional days in which to provide this response.

Your question to me was as follows: Would you object to the adoption of a law which says that all scrambling must be done in conformance with Videocipher II?

We do not think such a law is necessary.

The rationale for legislation on scrambling equipment is elusive and continues to shift. Last year it was justified on the ground that consumers should not be required to buy multiple descramblers to receive multiple satellite channels. That justification has been undercut by the adoption of the VideoCipher® II system as the de facto industry standard. One descrambler unit now provides access to all scrambled satellite cable programming.

Earlier this year the justification was that a law is needed to assure consumers that the VideoCipher II system would not be abandoned or changed and their investment rendered worthless. That justification appears increasingly weak as demand for descramblers has outstripped even our most optimistic expectations. Moreover, as the installed base rapidly expands, the tremendous investment which has been made by all concerned makes the probability of abandonment very slight unless required by government fiat.

In the 4 1/2 long years involved in establishing the VideoCipher II as the de facto industry standard (a status which it has unquestionably achieved among programmers and consumers), forward pricing, licensing and second source manufacturing concessions were made which protect the consumer. All major satellite TV programmers have chosen the VideoCipher II system. The VideoCipher technology has been licensed to virtually all competing manufacturers of satellite receivers (over 15) for integration into their products and a competitive manufacturing source for descrambler modules has been established.

As of July 31, 1987, at least $320 million had been directly invested in descrambling using VideoCipher II. As of that date, approximately 380,000 consumer descrambling units have been installed, authorized, or shipped to distributors and other manufacturers. Firm orders have been placed by the industry for an additional 400,000 descramblers, an indicatation that an additional $300-500 million will most likely be invested in scrambling using the VideoCipher II technology over the next 6-9 months.

Moreover, we do not intend to make any changes to the scrambling system which would render obsolete any of the VideoCipher II descramblers that consumers have purchased or the investment by the industry at large. Due to this very large investment by the industry and the strong economic incentive for programmers to serve the large and growing base of consumers using such descramblers, the probability of a change in technology is miniscule.

The best that could result from passage of a law on equipment at this stage is that it would merely ratify what the marketplace has already established; this is not needed. Such a law would not confer any benefit on consumers, programmers, commercial operators, distributors, retailers and manufacturers.

Improperly drafted, such a law could have unintended effects; create additional, prolonged controversy and confusion in the marketplace; freeze development; and threaten the rapidly growing investment which has already been made by consumers, programmers, commercial operators, distributors, retailers, and manufacturers.

Even properly drafted, we all recognize that new legislation is susceptible of different interpretations and lengthy litigation. This could have the effect of creating confusion and uncertainty in the marketplace.

If, however, legislation on scrambling equipment is inevitable despite its dangers, we would very much like to have an opportunity to have input into how the law is actually drafted.

For example, any such law should be directed at compatibility, not conformance, with the VideoCipher II, to permit enhancements to VideoCipher II and to permit the development of compatible products by other suppliers.

Because the law suggested by this question does not contemplate FCC action, it would avoid one of the biggest pitfalls of some current proposals, i.e., a long procedural delay which would be used by some opponents of scrambling to create confusion and uncertainty in the marketplace.

An attempt which at least commences with recognition of these two issues could conceivably result in a law that would do minimal harm to the development of the satellite TVRO industry.

But, for all the reasons cited above, we continue to believe that no legislation affecting scrambling equipment is needed and none, therefore, should be enacted.

Thank you for the opportunity to further expand and explain our viewpoint on this question. I am available to provide information and assistance to you and your staff on this or other relevant matters within our area of expertise.

Sincerely,

J. Lawrence Dunham
Executive Vice President &
General Manager

Senator GORE. Mr. Charles Ergen, president of Echosphere. Have I pronounced that right? In Englewood, Colorado. Please proceed.

STATEMENT OF CHARLES ERGEN, PRESIDENT, ECHOSPHERE CORP.

Mr. ERGEN. Thank you, Senator Gore. My name is Charlie Ergen. I am president of Echosphere Corporation. We are a national distributor and manufacturer of satellite television hardware.

I have my own Oliver North story on the satellite television industry. But mine is called the good, the bad, and you guessed it, the absolute worst.

The good is that we were able to survive in a new technology that was based on the satellite communications revolution. Small businesspeople like myself were able to start a small business with limited capital and grow it into a bigger business. We were able to bring information and entertainment to rural America.

The bad was that we were too good. We became a competitive threat to people who owned the old technology. And I think you heard it from some of those people on the first panel. I will not be redundant here.

The absolute worst deserves a little bit more consideration. Our industry chose the VideoCipher II technology as our de facto standard in 1985 and 1986, based on four promises from M/A-COM about that product. They made these promises to the Congress, to the FCC, and to our industry.

The first promise was that there would be an adequate supply. They told us that they had parts on order for 500,000 pieces. They told us that they had a capacity for 50,000 VideoCiphers a month.

The second promise that they made to us was that there would be full distribution to as wide as possible sources available. Any distributor, any distributor who was willing to order 300 pieces, and had good credit, would be allowed to sell and purchase a product.

The third promise that they made to us was that they would license second source manufacturers of the modules. Second source manufacturers.

And the fourth promise was that they had invested $20 million in this technology, and it was immune from piracy. Well, the worst ever for this industry was that General Instrument purchased their competitor, M/A-COM, in September of 1986.

Guess what happened less than one year later? They broke each and every promise that they promised our industry. Number one, we have been faced with severe shortages of product, despite orders from Echosphere Corporation and other companies one year in advance.

Mr. Dunham mentioned that I received 9,000 VideoCiphers in March. I did. I ordered them in May of 1986. And he still was not able to fill my complete order that I had given him one year in advance.

Shortages, when he produced product at 40 percent to 50 percent of stated capacity. He tends to change the numbers here, Senator, where he states capacity, but his actual production is much less.

Second promise, full distribution to all distributors. Well, as far as I know, General Instrument has not set up one independent distributor since acquiring M/A-COM. They have set up 10 of their own full line distributors.

Those distributors that agree to sell their other products, besides the VideoCipher. But if you want to buy just a VideoCipher product and you are a distributor in the United States of America today or Canada, you cannot buy a VideoCipher from General Instrument.

Senator GORE. Let me interrupt you there. Is that true, Mr. Dunham? Is that true?

Mr. DUNHAM. The way it is stated, no.

Senator GORE. Well, correct it, then. Are you refusing to sell to any distributor that does not take your entire line?

Mr. DUNHAM. No, sir. That is not true. A decision was made, I think it was back in the February or March timeframe, actually I think March, when the demand for the VideoCipher became very acute. It started building up sometime in the March timeframe.

At that point in time, when sales and marketing came in to us and said, we have some distributors that we want to add. At that point we were going into an allocation mode; compounded by the problem that we were having in getting Charlie more than 9,000 units per month at that point in time.

And I said, okay, we have to make a decision. We have a choice here. We can add 10 or 12 new distributors now that the demand is starting to pick up, they get in line, and we allocate product to them that other distributors ordered last year. The product would be taken from Charlie, and other distributors. I think 35, 36 of them had come forward over the last year and established distributor relationships.

We had to make a very difficult choice. And when we talked to the people we told them that this was the situation, we hope to get the capacity up, and as soon as we do, we will have open distribution.

As a matter of fact——

Senator GORE. Do you currently provide it to any distributor that does not carry your whole line?

Mr. DUNHAM. Absolutely.

Senator GORE. All right. Well, I am sorry to interject the question in the testimony. We will come back to it. We will give you a chance to respond.

Mr. ERGEN. Thank you, Senator Gore. I think that Mr. Dunham's answer gives you an idea of what we as hardware manufacturers and distributors are up against.

He has not, in fact, set up any new distributors. And I have the letter that I would like to enter into the record from a Mr. Kelly Goth, who has been in this business for six years, impeccable business record, who was denied access in May of this year to the VideoCipher technology.

In short, the letter says, in your letter, you state that General Instrument will make VideoCiphers available to any legitimate distributor as they testified to Congress last year.

I do not recall this company ever making such a statement. What I find ironic is that Remington Rand was a video distributor in 1986, yet failed to support the VideoCipher.

In other words, they punished them for not supporting it last year when they wanted to order it this year, although they had purchased the product apparently last year.

At the same time I received this in the mail, it says, they set up six new distributors in Canada. But they were full line distributors. And they set up four distributors in the United States, in Texas, Colorado, and several other states that carried the full line.

So Mr. Dunham has said we made a conscious decision, it hurt us so badly. But we just could not afford to be able to create, to hamper the shortage situation any more by setting up new distributors. But they yet still set up 10 of their own full line distributors.

I will continue on. The third promise was that they would license second source manufacturers. To this day General Instrument is the sole source in the world of the stand-alone decoder that sits in front of me. They are the only ones that manufacture it.

They had to abide by a license agreement with Channel Master, that M/A-COM made before the acquisition. But Channel Master has not been the competitive source in this industry. Echosphere ordered 50,000 modules from them in March of this year.

We have never even received an answer. And they do not appear in press statements to be competitive price-wise or delivery with General Instrument.

The fourth promise, and maybe the most important is, we were assured that the price of the VideoCipher was $395, because it took $20 million to develop it. The CIA could not break it.

Well, I am here to tell you that a $2 chip and two months later the VideoCipher was defeated. Two dollars to beat the $20 million technology. And when General Instrument had a chance to change that software, they did.

But when they had a chance to quit shipping the old software, they contained to ship the old software, and they put honest satellite dealers out of business.

The importance of this legislation before you is evident. It takes the first step. I may disagree with Mr. Dunham as to his marketing practices. But it is inarguable that his VideoCipher is our industry standard.

S. 889 needs to declare the VideoCipher the standard today. We cannot wait much longer. But there is one provision it must add. It must add that General Instrument must uphold the promises of M/A-COM, their predecessor, that they acquired. It must add that they mandate third party licensing.

This would ensure that we will never again have shortages. It will ensure that all forms of distribution, my competitors, Mr. Dunham's competitors, manufacturers and distributors, dealers and consumers will get a fair break and a level playing field.

Senator Gore, I thank you for allowing me to appear before you today. And I also want to especially thank those dealers and consumers that have called me and written to me in the hundreds and given me some input into this testimony here today.

[The statement follows:]

STATEMENT OF CHARLES ERGEN,* PRESIDENT, ECHOSPHERE CORPORATION

I started as retailer in the satellite receiver industry in 1980, and I am currently a distributor Board Member of the SBCA. While my comments are given as President of Echosphere Corporation, I believe they represent the concerns of many distributors, dealers and residential dish owners.

My appearance before this committee is to focus on the continuing problems that have plagued the satellite receiver industry and challenged the integrity of its product. For hardware distributors, satellite dealers and consumers, the immediate and pressing issue involves General Instrument Inc.'s (G.I.) Videocipher and five directly related problem areas.

I.—Shortages of Videocipher Descramblers
II.—Barriers to Competition
III.—Allocation of Videociphers
IV.—Widespread Piracy of the Videocipher
V.—The Necessity for This Type of Legislation

I.—SHORTAGES OF VIDEOCIPHER DESCRAMBLERS

After denying there was any shortage of Videociphers for the past six months,[1] G.I. finally admitted in late May there were severe shortages of Videociphers which would continue into the Fall of 1987. It would appear G.I. must have misread the market demand for its Videociphers, but this seems to contradict the following facts.

In comments to the Federal Communications Commission in October 1986, G.I. stated they had to commit to "volume orders of materials and labor for 500,000 (Videocipher) units".[2] Home Box Office (HBO) in its comments to the Federal Communications Commission, stated their contract with G.I. specified a 50,000 Videocipher unit per month capacity.[3] Just three companies, Echosphere Corporation, Channel Master and Anixter Communications together placed orders during 1986 for approximately 150,000 stand-alone decoders. Additionally, on February 19, 1987, Echosphere Corporation place orders for another 50,000 stand-alone decoders, and during the first quarter of 1987, also placed firm purchase orders for over 100,000 IRD modules. Many manufacturers and distributors, sensitive to the market's demand for Videocipher units, during this period of time, were also substantially increasing their orders.

The price of these units was set by G.I. on a "take it or leave it" basis because of the monopoly power it possessed due to the scarcity of the Videocipher units. This market demand, coupled with G.I.'s own internal information, clearly signaled G.I. had no choice but to increase production. It is remarkable during this time frame, when these market indicators were flashing, G.I.'s actual production was significantly less than stated capacity. Customers were, and are currently, about to receive only a fraction of their orders for the remainder of 1987, with G.I. functioning as the mathemetician who is calculating their respective market share.

A second reason for this shortage may have been that G.I. understood all too well the industry demand. The critical shortage of Videocipher decoders benefited G.I. in two ways:

(1) G.I., during this period of scarcity, has been able to substantially increase its share in the receiver market because G.I., unlike its competition, suffered from no shortage of Videociphers. Receiver manufacturers who did not have an integrated receiver descrambler had to rely on the stand-alone decoder component to sell their receivers, or they would be virtually eliminated from the satellite receiver market. G.I.'s failure to supply adequate numbers of the stand-alone unit left the consumer and the satellite industry only one choice; the IRD receiver. This policy permitted G.I. to significantly increase its share in the IRD market at the expense of competing manufacturers such as Chaparral, DX, Panasonic and Uniden. The recent departure of Luxor of North America was in part attributable to the scarcity of the stand-alone decoder of which G.I. is the sole source of supply. As a result, G.I. has forecast that it now commands 25% market share in the receiver market and will double this share during the next year to 50%.[4]

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* The exhibits referred to throughout this statement were not reproducible.
[1] Exhibit A.
[2] Exhibit B p. 16.
[3] Exhibit C. pp. 20, 21.
[4] Exhibit C2.

(2) In the absence of effective competition in the marketplace and the videocipher shortages, G.I. is positioned to raise residential decoder prices as they have in the commercial descrambling market. (In December 1986, G.I. raised the distributor price of commercial Descramblers by 20% from $385.00 to $460.00.)

II.—BARRIER TO COMPETITION

The barriers of entry G.I.'s competitors must overcome in the stand-alone decoder market is formidable as G.I. possesses monopoly power because it is the exclusive supplier of this product. This is vividly demonstrated by the fact that even their exclusive licensee Channel Master, under the terms of its agreement with G.I., after manufacturing a decoder module has to sell it first to G.I., and in turn Channel Master must repurchase their own module which G.I. has merely inserted into the stand-alone decoder box. It is hard to believe that Channel Master as a sole licensee cannot manufacture either the three chips containing the descrambling software or the stand-alone decoder.

Chairman Patrick of the Federal Communications Commission in his testimony before the House Telecommunications Subcommittee stated there are currently 38 programmers using G.I.'s Videocipher technology. The number of existing dish owners in the United States are approximately 2 million.[5] If any of these consumers want access to encrypted programming using their existing receiver, they will have to buy a G.I. stand-alone decoder because it is the only source for this product.

Mr. Larry Dunham, Executive Vice President of G.I.'s Videocipher division, stated before the House Telecommunications Subcommittee there was no need for additional licensees to manufacture the stand-alone decoders because of the lead time involved to come on line and the relative inelasticity of this market. Pressed further during this proceeding, Mr. Dunham indicated G.I. has no intention of permitting a competitive secondary source to manufacture the stand-alone decoder or the three proprietary chips because his company had to recover its capital investments from these products.

The barriers to enter the IRD receiver market maybe more subtle but are equally effective. In G.I.'s comments to the Federal Communiation Commission, it states in order to receive a license to insert a Videocipher module into a receiver, a receiver manufacturer must first go to their competitor, G.I., for approval.[6] This is a time-consuming and frustrating process for its competitors.[7] G.I. has on many occasions promised an independent lab would be used for the necessary testing approval, but to date, this designation of an alternative test facility has not been made by G.I. despite repeated demands from our industry.

In conjunction with a manufacturer submitting its product to G.I. for testing, they must additionally provide their instruction manuals. This gives G.I. not only the ability to analyze but adopt any desirable features contained in its competitor's units. This one way flow of information restricts product innovation in an industry premised on rapidly changing technology.

Another impediment to entry is G.I.'s policy of not shipping any Videocipher modules to a competitor until 60 days after a receiver has obtained G.I.'s approval, thus denying competition access to the market during a crucial time period. Additionally, current lead time for module orders is 120 days or more, thus further delaying competitive entry into the market. Warranty service on the IRD is an additional barrier because G.I. will not allow a licensed receiver manufacturer to ship a videocipher module without the entire receiver.

This restrictive practice results in consumers having to ship their entire receiver unit back to G.I. or the receiver manufacturer in order to obtain service of the module necessary to descramble programming. This G.I. policy unnecessarily and unjustifiably increases the public's cost as well as the loss of product use.

III.—ALLOCATION OF VIDEOCIPHER DECODERS

The third issue of industry concern is the allocation of stand-alone decoders and Videocipher modules. Due to the current shortages, G.I. can exercise monopoly power over their competitors in two ways:

(1) If the shortage of stand-alone decoders continues, G.I. through its allocation of the units in the market can gain an even greater share in the IRD receiver market

[5] Exhibit C2.
[6] Exhibit D p. 17.
[7] Exhibit E.

than it has predicted.[8] Moreover, G.I. can cross-subsidize this effort through the sale of its stand-alone decoders which are not subject to competitive pressures.

(2) If G.I. continues to favor its own "full line distributors" in allocating the supply of decoders, it can significantly lessen competition from alternative and less costly distribution methods. A demonstration of G.I.'s market power to allocate occurred in April of this year when it became legal to sell Videocipher decoders in Canada. When the Canadian market opened, the only companies who received stand-alone decoders were G.I.'s full line distributors of satellite receivers and components.[9] Independent companies desiring to enter this Canadian market were subjected to periods of delay in receiving stand-alone decoders not imposed upon G.I.'s full line distributors and to may knowledge have not yet received any decoders. The "head start" given to G.I.'s full line distributors is a crucial actor in determining which companies will survive in the Canadian satellite receiver industry.

Despite the fact it is the sole source of stand-alone decoders G.I. in its comments to the FCC stated it was willing to distribute stand-alone decoders to any distributor who would agree to "take at least 500 units." [10] However, since early 1987, it is my understanding no independent G.I. Videocipher Distributor has been added despite requests from numerous distributors. However, General Instrument has added several full line distributors (those who also agree to sell other G.I. satellite products) as Videocipher distributors.[11] G.I. in its comments filed with the Federal Communication Commission, also promised to license third parties for module production, but again this was merely "smoke and mirrors," because it subsequently rejected such requests by several manufacturers including Echosphere.[12]

G.I. has often commented there is no need for further licensing of its module because Channel Master has a license to manufacture G.I.'s Videocipher modules in the event there is a shortage, but this is just another illusion. To date, all of Channel Master's production of Videocipher modules has been sold back to G.I. Additionally, Channel Master has introduced its own IRD receiver thereby removing much of the incentive it may have had to sell their Videocipher modules to its competition in the IRD receiver market.

Echosphere ordered 50,000 Videocipher modules from Channel Master in March, 1987 [13] and to date, we have had no response to this purchase order even though it involves millions of dollars.

IV.—WIDESPREAD PIRACY OF THE VIDEOCIPHER

The fourth problem area is the widespread piracy of the Videocipher signal. Piracy enables many consumers to watch scrambled programming free of charge. It is estimated by G.I. as many as 50% of all Videociphers shipped to date are penetrable by pirates. However, it is common knowledge in the marketplace, despite all of G.I.'s counter measures, almost all Videocipher shipments to date are susceptible to piracy.

Even more disturbing have been statements concerning piracy by Larry Dunham of G.I. In May 1987, at an SBCA Board meeting, G.I. stated while some piracy had occurred in the past. G.I.'s modifications to the software in February 1987 had resulted in making its VC II units practically impenetrable. Mr. Dunham even succeeded in having the SBCA Board pass a motion commending G.I.'s efforts to effectively control piracy.

Echosphere's records indicate these facts were inaccurate, because it was still receiving decoders with the old vulnerable software in March, April, May and June of this year. I addressed this piracy issue in a letter to Mr. Dunham dated June 16, 1987.[14] Mr. Dunham has failed to respond to this letter, but he did candidly admit in a published interview[15] that G.I. did ship descramblers that were vulnerable to pirates long after G.I. possessed new software that would have, in his opinion, eliminated the problem. This piracy problem is resulting in the loss of millions of dollars of revenue to both programmers and cable operators and will inevitably be passed through to the public in higher costs for those services and products. In addition honest satellite dealers have been faced with the difficult choice of going out of business or condoning piracy.

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[8] Exhibit D.
[9] Exhibit E2.
[10] Exhibit B, p. 5.
[11] Exhibit E3.
[12] Exhibit F, p. 2.
[13] Exhibit G.
[14] Exhibit H.
[15] Exhibit I.

V.—THE NECESSITY FOR THIS TYPE OF LEGISLATION

Let me now review these four industry-wide problems.

1. Videocipher shortages.
2. Barriers to competition.
3. Allocation of Videociphers.
4. Widespread Piracy of the Videocipher.

All four of these problems affect the consumer in a negative way. As a result of G.I.'s monopoly, the current satellite owner is forced to pay a premium for a stand-alone decoder, or their only alternative is to purchase a new IRD receiver, at a substantial increase in cost. The unavailability of stand-alone decoders make existing residential dishes almost obsolete.

G.I.'s burdensome and complicated IRD licensing process stifles competition and new product development. Its unjustified practices regarding the sale of its Videociphers by independent sources and the servicing of its product are equally offensive to the consumer. These policies of G.I. affect the consumer by restricting their selection of satellite receivers and increasing product cost.

G.I. through its monopoly on stand-alone decoders and descrambling software in reality regulates the market. The testimony before the House Telecommunications Subcommittee by a retailer and distributor who were not part of G.I.'s full line distribution system clearly indicates the marketplace in this industry cannot function efficiently because of G.I.'s unequal bargaining strength, anti-competitive factors, and monopoly power in the receiver market. The testimony before the Subcommittee indicated there has been an 80% drop in dish sales and the loss of at least 50% of the distributors and retailers in the HSD industry since 1985. G.I.'s monopoly power has contributed to this decline and has inhibited innovations that are needed by our industry.

Many satellite dealers in the market have to sell pirated receivers or they will be forced to shut down because of existing market conditions. Reason dictates consumers will wait and see if existing technology can create a secure scrambling system before deciding to purchase a home satellite system.

I did not come here just to lay our industry problems upon the Congress without offering a suggestion for its solution. I would strongly endorse the recommendations of the Congressmen on the House Telecommunications Subcommittee who asked if G.I. would voluntarily license qualified third party manufacturers to build the Videocipher module as well as the stand-alone decoder as quickly as possible. If this occurred, it would help eliminate the four problems I have discussed today.

Should G.I. decide not to license any other manufacturer in light of the past, present and foreseeable shortages of Videocipher units, then Congress should declare in this legislation the videocipher is the standard for descrambling and mandate compulsory licensing of this technology. There is no question that the videocipher is already the de facto standard for descrambling. G.I., by having a de facto instead of a de jure standard for Videociphers receives all of the benefits of monopolization without any disadvantages of government oversight. The usual competitive force that drive a free market cannot co-exist with such monopoly power.

The legislation before you involves an issue of greater importance than a workable descrambling marketplace, it concerns itself with the denial of the public's right and access to information under the 1st Amendment. It is inarguable the telecommunications industry is "affected with a public interest" and Congress has retroactively mandated compulsory licensing in other industries impressed with such an "interest".[16]

The benefits of the mandating of a standard and compulsory licensing of Videocipher technology in this legislation would be:

(1) Competition and technical innovation would once again be the driving force in the marketplace resulting in the consumer being offered a wider choice of products at competitive prices.

(2) With more licensed companies in the market, you would increase the number of people policing and piracy seeking its elimination.

(3) Present and future shortages would be eliminated, giving the public instant access to the newest technology.

I urge your support of this legislation on behalf of the satellite dealers and consumers everywhere.

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[16] Exhibit J.

Senator GORE. Thank you very much. We have an unusually significant vote on the floor of the Senate. Senator Exon went over early to vote and will re-open the hearing when he returns.

But at this point we are going to have to have a very brief recess. I anticipate that it will take no more than five to 10 minutes. But then we will continue with our final three witnesses and questions.

So for the next 10 minutes or so, we will stand in recess.

[Recess.]

Senator EXON [presiding]. We appreciate the patience of the witnesses very, very much. We are going to move to getting right along.

And as I understand it, Mr. Hobbs is the next witness to testify. And we welcome you, Mr. Hobbs. Is Mr. Hobbs here? Well, go ahead with Mr. Timothy then. Mr. Timothy, we would be glad to recognize you at this time, and would you please proceed.

STATEMENT OF RAYMOND J. TIMOTHY, GROUP EXECUTIVE VICE PRESIDENT, NATIONAL BROADCASTING CO., INC.

Mr. TIMOTHY. Thank you. My name is Ray Timothy, group executive vice president with the National Broadcasting Company, Inc.

I am here today before this subcommittee to discuss an innovative arrangement with Netlink, which we hope will deliver our network television programs to unserved areas of rural America.

Because the NBC television network reaches about 99 percent of the television homes in the United States, access to our programming has not been an issue to most Americans. But 99 percent penetration is not full service.

During the process of formulating this arrangement with Netlink, NBC has been guided by two basic principles. First, it has always been our objective to achieve a nationwide network service.

In responding to a Congressional inquiry about scrambling, I stated that NBC is in the business of increasing viewer levels, not denying service to viewers. And that ultimately, we would want all American viewers to have access to our news, information, and entertainment programs.

NBC wants to furnish its service to rural viewers, like Diane Davis of St. Joe, Arkansas, if she cannot receive NBC programming through access to a network affiliate station.

Secondly, it is essential that NBC maintain a strong network affiliate system. NBC programming is provided to our affiliated stations for their exclusive use. These stations retransmit our programs together with local programs to their service areas.

I want to emphasize here that the combined network and affiliate service delivered to the public through community-based stations represents the very essence of the American broadcasting system.

Preservation of this unique system is a major priority of ours. Mindful of these basic principles, NBC has monitored the so-called scrambling controversy in Congress with great interest. Although this controversy mainly concerns program distribution issues involving cable systems and satellite cable programmers, NBC is sensitive to the legislative goal of assuring equal access to programming by home satellite dish owners.

In essence, NBC has agreed with Netlink to provide our entire network programming service, originating from KCNC-TV, the General Electric television station in Denver.

This service will be offered by Netlink to any home satellite dish owner who cannot receive a local NBC affiliate off-the-air, and is not served by a cable system carrying an affiliate station.

The challenge has been to assure delivery of NBC programming to rural America, without undermining the network affiliate system, which has served the American public so well.

By employing scrambling in a way that only those residing in unserved areas will be able to receive our programming, combined with an audit program to guarantee that authorized decoders have not been removed from these areas, we believe the network affiliate system can be adequately protected.

In fact, the arrangement has the support of the NBC affiliate board, whose members worked carefully with us to ensure that a complementary rural service could be created. A number of sources hold the rights to programming aired on our network. Thus, in some instances, NBC or KCNC-TV may not have the right to authorize this service for all scheduled programs. Certainly, when program rights owners license a network to broadcast their programs, service to the entire nation is anticipated. We therefore hope and expect that program suppliers will join with us in extending the reach of our programs to unserved home satellite dish owners.

Neither GE nor NBC will receive compensation from this arrangement.

We are undertaking this initiative as a public service, so that outlying areas of rural America, which might not otherwise be able to get the news from Tom Brokaw, or the family entertainment of the Cosby show, or important children's programming such as Main Street, will be able to receive such programs.

NBC believes the Netlink type of arrangement is the most appropriate and realistic means to deliver network program service to rural dish owners. We encourage other television services to join in providing this service.

Finally, I want to comment briefly on S. 889—The Satellite Television Fair Marketing Act. First, we are pleased that the bill does not ban network scrambling. Our network program material is private property and, at some future date, NBC intends to scramble its satellite transmissions to protect against unauthorized interception.

S. 889 also requires the Federal Communications Commission to undertake a rulemaking proceeding considering, among other matters, whether current rules inhibit broadcast service from reaching areas outside Grade B contours. This is an important proposal. Many television stations offer local news and information programs intended to serve areas beyond Grade B contours. Network programming naturally accompanies that service. With the growth of cable systems, signal strength contours have become artificial boundaries which no longer reflect the actual local service area of network affiliate stations. Netlink is aware of these realities, since their package will only be offered in truly unserved areas.

In summation, we believe the NBC Netlink arrangement will be responsive to several important interests at the same time. The need to reach truly unserved areas, preservation of our network affiliate system, respect for the principles of localism, protection of our program property rights, and the achievement of a solution by private action without government intervention.

Thank you, and I stand ready to answer any questions you might have.

[The statement follows:]

National Broadcasting Company, Inc.
30 Rockefeller Plaza
New York, NY 10112
212 664-4444

NBC

June 22, 1987

Netlink
5808 Lake Washington Boulevard, N. E.
Suite 101
Kirkland, Washington 98033

Dear Netlink Partners:

Pursuant to our recent conversations, I am writing to inform you that NBC has decided that as a public service it is prepared to authorize the distribution of the NBC Television Network programming carried on station KCNC-TV in Denver to home satellite dish owners who live beyond the reach of any NBC network affiliate's signal. GE, the licensee of station KCNC-TV, would similarly authorize distribution of that station's signal.

In conjunction with this decision, NBC and GE would be willing to permit American Netlink (hereinafter "Netlink") to distribute station KCNC-TV's signal to the home satellite dish market, consistent with a number of general policy principles and specific conditions which are set out below.

General Policy Principles

NBC wants all rural Americans to have the same access to the network's information and entertainment programming that urban, suburban and most rural Americans enjoy. Fortunately, only about one percent of all households are located beyond the reach of a local NBC affiliate, and are thus unable to view the news, public affairs, sports and entertainment programming provided by the network. NBC is committed to attempting to remedy this situation.

In devising a remedy, NBC feels it must take great care not to disrupt the network/affiliate system which has been developed over the years, consistent with the government's television frequency allocation policy, to provide the public with an optimal mix of local and national programming through community based broadcast stations. Thus, only home satellite dish owners who do not have access to the NBC network schedule because they are either unable to receive the NBC programming off-air, or are not passed by a cable system carrying an NBC affiliate, would be eligible to receive the service on a direct to home, satellite delivered basis.

It is NBC's position that distribution to home satellite dish owners of programming carried on the NBC Television Network may only be undertaken with the express approval of NBC, and that it is illegal under the Copyright Act and the Communications Act for the programming of NBC or its affiliates to be distributed to dish owners without the express authorization of NBC.

In authorizing distribution of network programming to home dish owners, NBC and KCNC-TV will grant permission to distribute the network's programming, and the station's programming and signal, to the extent they have the rights to do so. That is, while NBC and KCNC-TV hold the rights necessary to effectuate this plan for certain of the programs distributed over station KCNC-TV, these rights to some NBC programs may be held by others, which license these programs or rights exclusively to NBC. Because of the rights NBC holds in the programming licensed exclusively to it, neither NBC programming nor the affiliate's signal may be distributed to the home satellite dish market without the permission of NBC.

NBC and KCNC-TV will enter into a contract with Netlink in order to achieve availability of the network programming to those home satellite dish owners who are unable to receive NBC network programming from any NBC affiliates either off-air or on cable. NBC will agree to convey any rights it possesses which are necessary to assure that eligible home satellite dish owners can receive the NBC-TV network programming. However, with respect to certain programs, NBC may not possess the rights necessary to authorize this use of the program material. Therefore, complete fulfillment of this plan may necessitate that the producers or rights holders of certain programs carried on the NBC Network agree to allow their programs to be distributed to home satellite dish owners. In any case where it may become necessary for Netlink to obtain such permission, NBC stands ready to help facilitate the process.

NBC would permit distribution of the programming on the basis that the retransmitted TV station signal is securely scrambled, and that an addressable decoding system is employed, in order to strictly limit viewing to those members of the public who reside in areas eligible to be authorized to receive such service. It is our understanding the Videocypher II system will be used to scramble the network programming, in order to assure that eligible home satellite dish owners will be able to use the same decoder box that is capable of receiving satellite delivered cable television services.

NBC, consistent with its policy of providing its broadcast network programming at no charge to the viewing public, believes that home satellite dish owners living beyond the reach of a network affiliate should be able to enjoy access to NBC programming as inexpensively as possible.

Therefore, NBC will agree to distribution of its programming to home satellite dish owners on the express condition that any charges to dish owners for receipt of the network programming, whether KCNC-TV is offered individually or as part of a package, will be as low as is reasonable to effectuate delivery of the service. Thus, neither NBC nor GE will receive any compensation for the reception of NBC or KCNC-TV programming from dish owners during the term of this agreement, as long as producers and other rights holders of programming aired by the network and the station are also willing to forego compensation.

You have indicated it is your expectation that any payment to be charged by any authorized distributor to receive KCNC-TV and its NBC network programs, along with any other networks and their affiliated stations which agree to participate in such a plan, would be approximately $24 a year for an entire package of network stations.

Below are listed certain specific conditions which would be incorporated into the agreement authorizing distribution of NBC and KCNC-TV programming to home satellite dish owners:

Specific Conditions

1. The NBC Television Network and GE, licensee of KCNC-TV, will authorize distribution by Netlink of NBC-TV Network programming and KCNC-TV, for reception to those home satellite dish owners who live beyond the reach of an NBC network affiliate, and are unserved by a cable system carrying an NBC affiliate, except to the extent such authorization would violate the right of copyright holders or other rights holders in such programming.

2. NBC will authorize distribution of its programming to home satellite dish owners only on the condition that the programming is securely scrambled, and that its use by dish owners is exclusively limited to private, non-commercial viewing in a single family residence.

3. The authorization will be granted on a non-exclusive basis. NBC reserves the right to authorize other packagers, distributors or satellite carriers, to provide the NBC Television Network programming to the home satellite dish market, as do GE and KCNC-TV for KCNC-TV's programs and signal.

4. The authorization will be subject to revocation by NBC or GE if at any time reception of the retransmitted signal of KCNC-TV is not strictly limited to eligible home satellite dish viewers. Those backyard dish viewers who are eligible to receive the station are those that are presently unable to receive an NBC affiliate station because the area in which they reside is beyond the reach of such an affiliate, and is also unserved by a cable system carrying NBC network programs.

5. Home satellite dish owners eligible to receive the service will be authorized to do so by contacting the nearest local cable operator or other provider of satellite delivered services to the home, which are approved by NBC or another authorized party, and meet the specific standards set forth by the network. Those standards shall include a requirement that the following conditions be observed and enforced: a) the dish owner receiving service certifies he is eligible for the service;

b) if the dish owner does not certify his eligibility in writing on a timely basis after receiving service, service will be deauthorized; c) the cable operator or other provider transmits a record of all home dish owners who have subscribed to the service, to the NBC affiliate station that is nearest to the dish owner's residence, if the station has indicated it wishes to receive such information; d) if an affiliate asserts that any dish owner claiming eligibility is in fact not eligible to receive the service, service to that viewer will be deauthorized within 30 days unless his eligibility is clearly established; and, e) if a dish owner moves, in order to continue to receive service, his eligibility must be recertified.

6. Any deletion or alteration (other than scrambling of the signal) of any material broadcast over station KCNC-TV -- including all programming, advertisements, public service announcements or promotional material -- is strictly prohibited, and any deletion of material, or alteration of the station's signal, will result in the revocation of the authorization.

7. No packager, satellite carrier, cable operator, or other provider, or an affiliate of any such entity, will be permitted to provide NBC programming to the home satellite dish market or serve as a descrambling authorization agent for home satellite dish reception of NBC programming transmitted via KCNC-TV, if such carrier, packager, operator or other provider retransmits, distributes, or authorizes reception by home satellite dish owners of NBC network programming or the signal of an affiliated station, without the express permission of NBC and the affiliated station whose signal is being retransmitted.

8. Netlink shall conduct an audit program once a year to ensure decoder boxes authorized to receive the NBC network programming are not in possession of those ineligible to receive the service, and have not been removed from those geographic areas where NBC programming is unavailable.

9. The agreement with Netlink will be for a duration of two years, which is the same term that NBC's contracts with its affiliated stations is limited to by law. During this two year period NBC will carefully review whether both the goals of assuring access to NBC programming by home satellite dish owners in unserved areas, while also preserving the present network/ affiliate system, are being met.

If the preceding principles are acceptable to you as a basis for an agreement, please indicate your response as soon as possible. Consistent with the general policies and specific conditions set forth above, we look forward to entering into an agreement with you in the near future so that home dish owners unable to receive NBC programming may do so as quickly as possible.

Sincerely,

Thomas S. Rogers
Vice President, Policy Planning
and Business Development
National Broadcasting Company, Inc.

Roger L. Ogden
President
G. E. Property Management Company
of Colorado, Inc.
(Licensee of KCNC-TV)

Senator EXON. Thank you very much, Mr. Timothy. Ms. Diane Davis, we are pleased to recognize you.

STATEMENT OF DIANE FRIEDEL DAVIS, SATELLITE DISH OWNER, ST. JOE, AR

Ms. DAVIS. Thank you, Mr. Chairman. I am Diane Davis from St. Joe, Arkansas. And I am strictly a consumer.

I live in the rugged Ozark Mountains of northwest Arkansas, where I do not receive an over-the-air signal from my three network affiliates 100 miles away. For this reason, I am outraged at the plans of the broadcast networks to scramble their satellite signals.

By using the VC I, networks will deny us access to their programming on our public airwaves, which reaps them healthy profits. Their arguments rationalizing these tactics sends a message loud and clear that says, networks don't care because they don't have to.

I find their insensitive actions a violation of my first amendment rights. I find their callous disregard of those in white areas discriminatory. Furthermore, many white areas contain people in the metro, grade A and B contours.

There is a present danger spreading throughout this portion of the telecommunications industry called monopoly. The networks, NBC in particular, are colluding with Netlink, who is owned by TCI, the country's largest cable company, to selectively market their programs, while refusing to deal with any other cable or satellite programming services.

Therefore, if Americans in white areas want access to network programming, they will be forced to deal with this monopoly. The remedy is real third party programming.

Someone once said what this country needs is a good five cent cigar. I say what this country needs is a good $99 decoder, complete with a standard encryptian system, to ensure consumer protection.

The P in PBS and CPB stands for public. AFRTS is our tax dollars at work, benefiting people in the armed forces. It is unacceptable for our money to be used for scrambling these signals.

The networks, cable companies, programmers, including newspapers and magazines, are vertically and horizontally integrated corporations. If this incestuous pattern is allowed to continue, a few corporations will control our media and our airwaves.

When such control rests in the hands of a select few, they then become more powerful than our government, and we will play by their rules.

Senators, we are weary, we are angry, we are broke. We have been called pirates, crooks, and thieves. We have even been arrogantly informed by a Congressional aide that TV is a luxury, and we rural people chose to live in remote areas of this country.

Our FCC, once watchdog for the public good, has now become guard dog for corporate greed. The Justice Department refuses to search out and discover obvious wrongdoing. We are not the real pirates, crooks, and thieves. They are out there in the shadows, waiting to create a George Orwell society.

The marketplace is not working. The decoders are not reasonably priced. The networks, PBS and AFRTS, do not have the right to scramble our public airwaves. But this issue gets bounced about like a ping pong ball.

The buck keeps getting passed. And everyone has answers to everything, but solutions to nothing. Well, Senators, we have found the solution. It is called Senate bill 889. You can show us your strength and courageously demonstrate your support of our rights, by moving for immediate passage of this bill. Thank you.

[The statement follows:]

STATEMENT OF DIANE FRIEDEL DAVIS, SATELLITE DISH OWNER [1]

"While the right to talk may be the beginning of freedom, the necessity of listening is what makes that right important."

--Walter Lippman
Harvard University

As a consumer and the owner of a backyard satellite dish, I am greatly concerned about the announced scrambling plans of the three major broadcast networks (NBC, CBS, and ABC). I believe their actions to scramble their signals to the satellites are discriminatory and clearly a violation of our First Amendment rights. For as long as I can remember, the news media has emphasized **their** First Amendment rights, stating that the public has a right to know. Therefore, keeping that theory in mind, if the networks have the right to gather news and report it, then we, the satellite dishowners as part of that public, have the right to hear it. After all, where would be the need or motivation to distribute a product if there was no consumer to receive it?

I live in the northwestern part of Arkansas. All three of my broadcast network affiliates are over one hundred miles to the south. The region that I reside in is a rugged, isolated one consisting of lofty ridges, limestone bluffs, natural caverns, and spring-fed streams and rivers. But while this area has a mystic beauty that captivates many, it is this same terrain which wreaks havoc with a television signal, making it impossible to receive any of the network affiliates in Little Rock. (Refer to Appendix, Pages 1a and 2a for signal survey done on my property by the CBS affiliate in Little Rock.) Occasionally, we receive a weak, sub-standard signal (NBC) out of Springfield, Missouri, one hundred miles to the north; however, during the spring and summer months, we are afflicted with a weather condition known as temperature inversion, which literally scrambles our television picture and creates a loud audio buzz, thus making it totally impossible for us to even view that one station from Missouri. In fact, for days and weeks at a time, we only receive hit-and-miss programming, and are virtually shut out of any television viewing at all.

When we first moved here eight years ago and realized the sad state of television reception, we contacted the cable company thirty miles away in Harrison, but they informed us it would not be lucrative for them to come

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1/ The Appendices referred to throughout this statement were not reproducible.

out this far. After consulting various local antenna specialists, we installed a VHF antenna designed specifically for fringe areas, a signal booster, and a thirty foot antenna. But this equipment still did not appreciably improve our situation. We continued to seek a better solution, but were informed by all of the antenna specialists, including Rodney Sullins of Sullins Video Center, that a taller tower or a different booster would still not do the job because of the mountainous terrain and weather interference, as well as distance from affiliate signals. (Refer to Appendix, Page 3a for statement of signal problems by Rodney Sullins.) After suffering intolerable television viewing for several years, we finally made the decision in August, 1984 to purchase a satellite dish. . .no easy feat since my husband is a teacher and we are a one-income family with a daughter in college. But our dish was worth the financial struggle because we now receive a clear, crisp picture from all three broadcast networks regardless of weather, terrain, or distance.

When we purchased our dish, we were aware of the scrambling plans of HBO and other cable programmers, but that did not deter us since the majority of our television viewing involved the three broadcast networks. What we had **not** anticipated were the scrambling plans by those networks. Initially, after hearing this announcement, I indignantly exclaimed: "They can't do that!" But I was really dismayed when I learned that the networks planned to scramble using the Videocipher I, stating that decoders would not be available to the public, thus denying us any access. My dismay and indignation quickly transformed to outrage when I realized, like many other dishowners, that while denying us access, the networks would continue to make use of our public airwaves while enjoying very healthy profits. To illustrate this, the following is from USA Today, April, 1987:

CBS PROFIT ZOOMS 199%

> CBS Inc.'s first-quarter profits soared 199%, due mostly to a surge in earnings by its record unit and lower costs on its large debt. Net income was $48.7 million, vs. $16.3 million in 1986. Because of CBS' share buyback plan, which reduced the amount of outstanding stock, the per-share gain was 245%, to $1.93 from 56 cents in 1986.

Because the networks depend on advertisers for their existence, that advertiser has the right to reach all his market that he possibly can; and, because of primary tax-deductible advertisers' revenues, no national network should be permitted to scramble programming that is expected to reach all advertiser-intended marketing prospects. We, in rural America, purchase those products the same as everyone else. We, in rural America, pay taxes the same as everyone else. And we, in rural America, did not give up our right to know or our right to access that free flow of information just because we happen to live in what is known as a "white area." That is outright discrimination.

The networks speak of privacy for their signal, yet they voluntarily left the privacy of telephone lines in order to save millions of dollars by broadcasting their signal via the more cost-efficient satellite system. But though there are those who choose to ignore it, the fact still remains that those satellites are there because of a tax-supported technology. And every time a space shuttle roars into the atmosphere carrying a satellite, the taxpayers pick up part of the tab on that flight. Because that selected space in the sky -- that national resource -- belongs to the public just as surely as Yellowstone National Park, the public has the right to access, no matter what legal method they choose to use. In fact, Congressman Edward Markey, Chairman of the House Subcommittee on Telecommunications & Finance, recently stated that the networks "really are national parks." Therefore, if the networks are so intent on privacy and insist on refusing dishowners accss to their signal, they (the networks) should be forced to return to the waiting arms of AT&T's land lines.

The networks keep howling about protecting their raw newsfeeds. We say, fine. Scramble those backhauls and raw newsfeeds, but leave the fronthaul prime-time feeds in the clear intact with national advertising. The networks say no. . .too costly. The networks keep reiterating that they must protect their affiliates from being by-passed, yet there is no hard evidence that their affiliates need this protection. In fact, to the contrary. Case in point: NBC recently conducted a survey that revealed the majority of people prefer local newscasts over network newscasts. (Refer to Appendix, Page 4a, for the news article of this survey.) Furthermore, in the March, 1987 issue of Satellite Direct, Jack Lease, vice-president of programming and operations at WXIA, the Atlanta NBC affiliate who is being uplinked by Satellite Broadcast

Networks (SBN), stated that SBN is not harming his station. To quote Mr. Lease from this same article: "Saleswise, it hasn't affected us."

To carry this a step farther, if the networks are so concerned about their affiliates, why then are they planning to cut them off at the knees? According to TV Guide of January 3, 1987, ABC is preparing to slash 9% out of its $125 million per year that it pays its affiliates for programming; in fact, as early as 1987, ABC proposes to stop paying its affiliates to carry the top ABC events. The ABC affiliates are irate over this. CBS, in this same article, revealed its plans to consider the same action. Does this sound like a concerned parental attitude by the networks toward their affiliate children? (Refer to Appendix, Page 5a, for this TV Guide article.)

Glowingly, the networks speak of the remarkable new satellite technology which offers more choice in the gathering and dissemination of news. They proudly boast of streamlining their network news on one hand while hastily spending money with the other to scramble; they delightfully take advantage of this new technology yet blatantly deny us the same opportunity. According to Lawrence Grossman, president of NBC news, before recent House subcommittee hearings: "The goal of our effort to operate more efficiently is not to diminish our service in reporting the news, but to improve and enhance NBC news serice to our growing audience." When inserting Mr. Grossman's statement into the present scrambling plans of the network, I find his statement to be ridiculously incongruous. By scrambling, the service **will** become diminished. And one does **not** "improve and enhance" to a "growing audience" by scrambling a broadcast signal. Therefore, if dishowners are to be ignored as part of that growing audience, it is a further illustration of discrimination rearing its ugly head.

Ultimately, the subject of translators must come up, since translators seem to be the favorite jargon these days with both the networks and the FCC. But the networks have lied about providing rural America with translators, knowing all the while that translators are a dead expense, have a poor history, and that most affiliates around the country have absolutely **no** plans whatsoever to install translators in the so-called "white areas." After all, why would the affiliates want to invest in an obsolete technology? This translator ploy on the part of the networks appears to be nothing more than a stalling tactic designed to pacify our legislators while proceeding with scrambling plans.

In the fall of 1986, I was involved in conducting an affiliate survey in which dishowners around the country were asked to poll their affiliates about their plans to apply for and install translators. The answers from the various affiliates polled came back a resounding **NO!** Some of their comments were: "Sometimes they (translators) work, sometimes they don't, mostly they're just a hassle;" or, "We're not in the translator business." My own three affiliates in Little Rock informed me that they have absolutely no intentions of installing translators in my area: that translators were too costly, the networks were not willing to help pay for them, sufficient revenue did not exist in our area, and one affiliate president even told me that it was the attitude of the FCC that anyone residing outside a Grade B contour was not supposed to be served. I informed my affiliates that the recent FCC report stated in part: ". . .it appears from the record herein that increased use of translators is a partial solution for future service to white areas. The networks and their affiliates also believe this to be the most viable alternative. . ." One of my affiliates laughed and said that was nothing more than a smoke screen. Another affiliate stated that this was a presumptuous statement on the part of the FCC since this was a station-by-station, license-by-license issue, and in no way were there going to be translators here in my area of northwest Arkansas. (Refer to Appendix, Pages 6a through 21a, for affiliate survey. It should be noted, at this point, that this survey was submitted to the FCC for their inquiry into the scrambling issue.)

Because I do believe that affiliates can provide a vital service to a community, and because, altruistically speaking, a translator would also benefit others in rural America who are not satellite dishowners but are also signally-starved, I originally was under the false impression that translators might be the answer. But as the outer layers were peeled away and the flaws of the translator issue leaped forth, reality popped into view. It was then I realized that this dinosaur technology would **never** be the answer. The following reasons state why:

1. One translator can range anywhere from $24,000 to $36,000 (and even more.) The cost depends on several factors: the height of the tower, the quality and gain of the CATV receiving antennas, construction of a protective weatherproof building, and a telephone interface which would allow routine maintenance checking.

2. Because of the need for electrical power, accessibility, and safety from vandalism, not just any location will do. Private property would be the most desirable, with location near a residence so that the property owners can keep an eye on the translator and notify the local affiliate should something need attention. This would require some type of lease agreement and monetary arrangement.

3. One translator would not fulfill the needs of many areas, such as my own northwest region of Arkansas, since the translator may have less than a thirty mile radius due to factors such as limit of power allowed by the FCC, weather, and terrain.

4. Microwave relays would also not be a viable solution in that the cost to a small affiliate, such as mine, would be prohibitive, since microwave relays can be as much as doubled or even more over translators and would require more service and maintenance.

5. Finally, and most importantly, translators are unreliable. Even with good, state-of-the-art electronic equipment, there is still no assurance of a consistently good quality picture from a translator. The problems would still exist of signals bouncing off mountains and hillsides, creating a ghosting effect, and the scrambling effects of temperature inversion. Severe weather, such as electrical storms, high winds, sleet and snow, would be a critical and constant problem, thus frequently damaging and knocking out the translator signal. In other words, all the difficulties that plague the standard VHF rooftop antenna would also plague the translator, except that resulting expenses due to repair, labor, and related complications would

be multiplied many times over that of the standard residential antenna.

(Refer to Appendix, Page 6aPettus; Page 7aAllen, and Page 9aFarmer. These are individuals who have purchased satellite dishes because translators in their respective areas have proven unreliable.)

The FCC continues to state that they have a large number of applications for translators and low signal television stations which, if processed quickly, would solve all our problems. However, I wish to take issue with this statement. I believe if those applications were checked, it would be discovered that the majority of them are for areas that, unlike many, would: 1) contain large cities with affiliates who can afford the costly installation of translators; or, 2) have communities that are financially solid, located near enough industry to provide a substantial revenue base, and can raise the necessary dollars to install a low power television station.

A lot of people seem to be doing a lot of talking these days about low power television stations. Obviously the people who are doing all this talking have never lived in northwest Arkansas and have no understanding of our economic situation here in the Ozarks. And I would hasten to add at this point that I do not believe my area is unique. I would venture a guess that there are other places in this country where similar economic situations exist. My area is depressed. The county I reside in -- Searcy -- covers 668 square miles, has 13.2 persons per square mile, and has a total population of 8,847. The average per capita income in this county is $5,787, with 61% of unrelated individuals falling below the poverty level. Unemployment is high (10.2%), with my county ranking 71st economically out of 75 counties in the State of Arkansas. We have no urban areas and our largest town, which is also the county seat, only has a population of 1,545 people. It is obvious that we have no revenue base and it requires a revenue base to support low power television stations, or to justify the installation of translators. It is estimated that network affiliates receive less than 2% of revenue from consumers who live over thirty-five miles away. Therefore, without sufficient revenue to support advertising spots, who would want to invest in such a snaky venture? Or, for that matter, who is going to drive one hundred miles to Little Rock for a cheeseburger?

I can state, without any hesitation, there are literally scores of people living in the Ozark Mountains in deep valleys and small pockets of land who receive little or no television signal at all off their VHF antennas. A large number of these people are far from wealthy and many exist on fixed incomes; however, because television is their only window on the world, many of them have leased, rented, or purchased dishes, since prices have dramatically dropped in the satellite industry. (Refer to Appendix, Page 22a, Sullins Video Center ad displaying easy purchase terms.) These people are presently able to enjoy the advantage of viewing network programming, something they have already paid for as consumers. But because of financial limitations, many of them are unable to afford ridiculously high-priced decoders or distorted monthly payments to cable programmers. Therefore, once the networks scramble, their window on the world will be closed. (Refer to Appendix, Page 23a, for article by Roy Reed colorfully depicting the television situation in the Ozarks.)

At this point, it must be stressed that not only rural people, or people residing outside a Grade B contour, will be affected by network scrambling. There are people presently residing within a metro contour or a Grade A contour who, because of irregular terrain, also cannot receive an adequate network signal from their affiliates. Please note the following explanation of the contours:

1. Metro contour - 12 to 15 miles.
2. Grade A contour - Up to 50 miles.
3. Grade B contour - 50 to 65 miles.
4. Outside Grade B contour - Above 65 miles.

Dale Hanson of Albuquerque, New Mexico, lives well within a metro contour (approximately two miles from Albuquerque); however, Mr. Hanson lives behind Sandia Mountain and cannot receive his network affiliates. Because of his close proximity to the affiliates, the installation of translators has not been considered since it is assumed he should receive the signal of a network affiliate. (Refer to Appendix, Pages 16a, 17a, and 18a for Mr. Hanson's letter, along with attached letters from two affiliates, Pages 19a and 20a. This material is all included with the affiliate survey.) As you will note in Mr. Hanson's letter, he had very poor responses to his letters and phone calls. In fact, his CBS affiliate refused to respond at all. And the replies from both the ABC and NBC affiliates were a shrug, stating there was nothing they could do.

Tom Wenrich of Thousand Oaks, California, also has a similar situation. He lives within a Grade A contour (approximately thirty miles from Los Angeles) and receives a substandard picture from his CBS and NBC affiliates. He states that while his ABC affiliate is a bit better, the picture quality is still poor. (Refer to Appendix, Pages 24a and 25a, for Mr. Wenrich's detailed letter.)

Bruce Tibert of Malibu, California, lives within a Grade A contour of Los Angeles. However, Mr. Tibert receives no over-the-air television, nor is there cable available. He states: "Even the Los Angeles Times won't deliver up the canyons. We rely on the satellite for all our news and entertainment." (Refer to Appendix, Page 26a for Mr. Tibert's letter.)

(For more letters that depict other people with similar problems, refer to Appendix, Page 27a, Warren Dean of Calabasas, California; Page 28a, Riley Morgan of Malibu, California; Page 29a, Anthony & Earleen Devivo and David & Mary Strong, all of Malibu, California.)

To carry this one step even farther, I lived in Auburn, Washington from 1970 to 1980 before moving down to Arkansas. Auburn is a bedroom community of Seattle, lying twenty-five miles south of Seattle, well within a Grade A contour. We had a good quality, tall rooftop antenna with a rotor, but because of a tree-covered ridge just north of us, we could **not** receive CBS **nor** PBS.

As I have clearly illustrated, this is not merely a rural problem. And it is logical to assume that in these various contours, if one person or family cannot receive certain network affiliates, then there are many others within that contour or area who cannot receive the networks as well. Also, it is estimated that there are approximately 800,000 cable subscribers who, without their cable systems, cannot receive the network affiliates. Furthermore, there are people who live in townhouses, apartments, and condominiums who, because of a landlord or a local association, are not allowed to install an antenna. They are in an "imposed white area" situation and must rely on cable to receive the networks. What happens to these people with the must-carry rules in jeopardy? Taking all this information into consideration, the estimation of 400,000 to 500,000 people in "white areas", a random figure so carelessly thrown out by the FCC and the networks, is not only misleading, but, in my opinion, a gross underestimation as well.

The networks state that by law they have the right to protect their signal. In fact, they hide behind this law, using it as a shield in order to evade their responsibility to the dishowner who is part of the public they supposedly serve in the best interest. But this so-called law has been tossed about for much discussion. Even legal minds have been unable to agree, stating it is too broad-based, open to interpretation, and really designed for commercial use rather than private. But I believe the bottom line here is not whether this law is applicable, but whether it is workable. I state that any law that discriminates against a segment of the American population, any law that harms the consumer, and any law that can be used to strip Americans of their basic First Amendment rights, is a bad law and one that **must** be changed.

It is absolutely amazing that the networks would want to reduce their number of viewers in light of the fact that they are all experiencing financial difficulties. Not only are the networks down 30% in advertising revenues, but they are presently in stiff competition with the increasing popularity of independent stations. Furthermore, the cable industry has elaborate plans to expand their programming to homes within their respective cable franchise areas. With the must-carry rule seemingly on the way out, the cable industry is looking toward bigger bucks spent on cable-produced movies and variety programming. And, there are serious efforts, some already successful, to seduce the NFL away from the networks. In fact, according to Howard Stringer, president of CBS news, there has been a 13% decline since 1980 in the combined viewership of the three network evening news broadcasts. Presently, the news division at CBS is embroiled in yet another upheaval. Laurence Tisch, CBS' president and chief executive officer, has engineered the slashing of $30 million from their budget, as well as layoffs of over 200 people.

Keeping all of this in mind, the following questions must be asked. Why, when the networks are in such a financial crunch, are they willing to spend hefty sums of money on scrambling equipment just to shut out what they state are a small percentage of the population (less than 1%)? Why are they taking such a hard stance against the satellite dishowners and throwing out the baby with the bathwater? On the surface, it would appear to be a bad business decision. However, if the facts are carefully examined, it would appear the networks are looking toward the future -- a future that would phase out the affiliates and phase in direct broadcasting. What better

way to boost revenues? What better way to control the dissemination of news and entertainment? David Londoner, a vice-president and analyst for Wertheim & Co., which is an investment-banking firm actively involved in entertainment and media work, stated in the August 21, 1986 edition of The Wall Street Journal: "There's going to be a major consolidation. By 1995, it wouldn't surprise me to see three major enterprises embracing 80% of the [broadcast and entertainment] business." Therefore, if the networks were to set a precedent now by allowing satellite dishowners access to their satellite signals, how could they later charge all American television households and justify it?

The networks have taken even further efforts to shut us out. Satellite Broadcast Networks (SBN), a new service recently appearing on the scene, has uplinked three network affiliates, scrambled them using the Videocipher II technology, and offered this service to dishowners at a rate of $49.95 per year. While I do not believe anyone should have to pay to watch the three broadcast networks, this does offer an alternative to the signally-starved viewer once the networks scramble. However, ABC, CBS, NBC, and Gannett have all filed lawsuits against this young company, alleging copyright violation when, in fact, SBN states that, like other cable systems, it is within the law to re-transmit affiliate network programming to those parts of the country that cannot otherwise receive a local affiliate signal. The networks argue that these re-broadcasts will unfairly compete with the exclusive markets of their affiliates. In effect, what they are singing is that same old tired tune about protecting their affiliates. This would appear to be an over-reaction in that why would anyone who receives their own local news, weather, and sports wish to pay $49.95 per year to receive someone else's. And, again, according to Jack Lease of WXIA, the Atlanta NBC affiliate being uplinked by SBN: "In most cases, there are local [network] affiliates that viewers can receive, and when they can get the network from the local affiliate, why would they want to pay additional money for the scrambled, out-of-town stations?" Therefore, it is logical to assume that the majority of people who would utilize the services of SBN would be those who live in an area unserved by an affiliate signal. (Refer to Appendix, Pages 30a, 31a, and 32a for SBN position.)

And where were the networks' objections in the early 1960's when the rotor antenna was introduced? By utilizing the rotor, one could move it 360° and aim the antenna in the direction of distant or difficult to get signals; thus, television viewers in certain areas could receive multiple network channels. For example, in Berkeley, California, a viewer could receive both Channel 7 from San Francisco and Channel 11 from San Jose, both of which were ABC affiliates. Over the Berkeley hills, in parts

of Contra Costa County, it was possible to receive not only Channel 7 and Channel 11, but also Channel 13, an ABC affiliate broadcasting from the Sacramento area. One could also receive Channel 5 from San Francisco and Channel 10 from Sacramento, both of which were CBS affiliates. And it is reasonable to assume there are many other areas around the country in which this is occurring. (In fact, there are many areas all across the nation where distant radio signals come in with more clarity than a local network radio affiliate. Do the networks intend to lower the output of their distant radio stations in order to protect the signal of their local radio stations?) The marketing of the rotor antenna continues today. Given the fact that antennas were available for multiple network signals more than twenty years ago, it would be logical to estimate that there are many more rotor antennas in use today than there are current satellite dishes.

And what about cable companies that broadcast not only local affiliates, but distant ones as well. For instance, TCA Cable in Harrison, Arkansas, offers all three networks from both Springfield, Missouri and Little Rock Arkansas. Why aren't the networks howling about this?

Now, the networks are in the process of negotiating a deal with Netlinks out of Denver for the uplinking of their three network affiliates for distribution to the dishowner. However, Netlinks is owned by TCI, the nation's largest cable company. When SBN originally tried to negotiate with the networks, they (the networks) refused. Instead, they filed four lawsuits against SBN. If the networks should win, it will not be a fair and competitive marketplace that will defeat this fledgling company, but rather the harrassing and intimidating tactics of the network oligopoly, dragging out their big guns and swooping in for the kill. And when the smoke clears, the dishowner will be the loser, because after the networks scramble, we will be forced to pay a price that is solely determined by the cable monopoly. Furthermore, unlike other Americans, the dishowner will also be forced to pay twice to see the networks, both as consumers and again through a subscription fee to the cable company. But this murky scenario does not stop there. The cable company, acting on behalf of the networks, will become our police by determining who should and should not be allowed to receive the network signal. It is obvious our free enterprise system is being manipulated and mauled. It is obvious the dishowner becomes the

victim. And it is also obvious that our First Amendment rights are being thoroughly violated. For these reasons, there must be a competitive marketplace in which the dish-owner may shop for a network signal.

To muddy the waters further, I would now like to address our own illustrious FCC. This is the same FCC who recently investigated the entire scrambling issue and produced a report that was nothing more than a white-wash job. They displayed a cavalier attitude toward rural America, leading the charge to protect the interests of the network industry, touting network policy, and completely disregarding the First Amendment rights of the American citizenry. They used points-of-law only when the rulings were favorable to their own interests, and ignored any rulings that might protect the overall rights of the general public. It is obvious that the FCC has shifted from being the watchdog for public good to the guarddog for corporate greed.

In their supposed nationwide investigation of the "white area" problem, the FCC concluded that: ". . .the magnitude of the problem is not substantial. . .;" and that a mere one-third of us that were: ". . .genuinely affected have alternative programming sources available for entertainment and national news." In reference to those of us who are "not substantial," they addressed our problem by stating this was beyond their control, or they did not have the authority, etc. By absolving themselves of any responsibility in this matter, the FCC gave the green light to the networks to proceed with their scrambling plans, tossing us to the wolves in the process. To carry this fairy tale one step farther, the FCC, in their new-found impotence, joined the networks in a raucous chorus of that song-of-songs: "Hail, hail, the translators are all here!" And, of course, once they have convinced everyone that these mythical translators will be popping up across America and that all is copacetic, they can then rest happy, reassured that the dishowner has been swept under the rug for good.

In rebuttal to our not being "substantial," I would like to state that since the FCC does concede that there is one-third of us who are signally-starved, I would like to ask how they can state that one-third of 1.6 million dishowners (their estimate) is not substantial. Keep in mind, we are talking about roughly 500,000 dishes, multiplied by three persons per household. That means the number of people unable to view the networks is a million and a half people. Furthermore, since there are

significantly many more rural Americans who do not have satellite dishes, but are residing in "white areas" (it has been estimated eight to ten million), what happens when large numbers of these people eventually purchase satellite dishes? Are we still considered "not substantial?" At what point do we become "substantial?"

The FCC states we have alternative programming sources. They would have us forced into a situation where we would have to purchase costly decoders and programming from the cable monopoly, or we would not receive quality programming at all. And is it the American way for its citizenry to be denied access to a multiplicity of news from the major networks and be limited to one news channel (CNN)? As consumers, we have already paid for that network programming. And there will always be people who, for various reasons (financial or otherwise), can not or will not purchase cable programming and the availability of news, information and entertainment would be limited to only those dishowners who could afford it.

Last year, in a letter to Senator David Pryor of Arkansas, Peter Pitsch of the FCC mentioned that I had a "wealth" of programming available to me, such as HBO, CNN, Disney, etc. (Refer to Appendix, Pages 33a and 34a for Mr. Pitsch's letter.) "Wealth" is the key word here since, under the present cable monopoly, wealth is what it would take to afford all those distorted prices. (I find Mr. Pitsch's tone reminiscent of Marie Antoinette. When told that her subjects were starving, she said: "Let them eat cake!") Mr. Pitsch then proceeded to lobby my senator on behalf of the networks, touting all the arguments and network policies that they (the networks) had been using on us for months. This angered me, since this was before the completion of the FCC inquiry, before all sides of the issue had been heard, yet Mr. Pitsch's attitude and policies were later reflected in the FCC report. So, as you can see, their minds were already made up long before.

As a final point on my being told I will have the availability of only one news source (CNN), I would like to quote two gentlemen who articulate my feelings and beliefs much better than I could. However, when these two men uttered the following words, I am sure they did not intend to include satellite dishowners.

Roone Arledge, president of ABC news, in recent House subcommittee hearings:

> "In the end our society will be better served by the competition that these other news sources will provide us, and by the multiplicity of news choices that the television audience will have."

Dennis Patrick, FCC chairman, in reference to AB switches:

> "Our bottom line obligation is to ensure that we maximize the public interest. This commission believes that the public is going to be best off in the long run if they have alternative delivery mechanisms for the delivery of video product rather than have a situation in which we'd have all video product delivered through a single line, as it were, the cable line."

On that score, I rest my case.

The networks have refused to negotiate or talk to the satellite dishowner in good faith. They and their affiliate children have the attitude: "We don't care, we don't have to." In fact, the president and general manager of the NBC affiliate in Little Rock informed me just the other day that he realized people up here in these hills had a signal problem, but he really had no solution. My understanding is that under the requirements of the FCC Act of 1934, local stations, licensed by the FCC, serve in the public interest. And while the networks do not fall under that license, they have traditionally embraced the same obligation that they served in the best interests of the public. To quote Howard Stringer, in recent House subcommittee hearings: "Our commitment to public service remains unabated and we continue to find new opportunities to keep our audience better informed."

If the networks are going to abandon their obligation to the public, would that not be grounds for necessary licensing by the FCC? When a local affiliate shrugs his shoulders while flippantly stating nothing is going to be done to serve those of us in signally-starved areas, has he not fallen short of the intent of the FCC Act of 1934?

This entire issue has been bounced around like a giant ping pong ball. Everyone passes the buck, refuses to listen, and has answers to everything and solutions to nothing. Well, we found the solution. It is called satellite television, but now we are being castigated for our resourcefulness. We have been called pirates, crooks, and thieves by the cable industry, programmers and networks. A Congressional aide even arrogantly informed me that television was a luxury, that we (meaning rural people) chose to live in remote areas of the country, that we did not have to purchase the products the networks advertised, and that this was not a First Amendment right. And, of course, the FCC does not consider us "substantial." Somehow, I was always under the impression that a true Democracy protected the rights of its minorities.

In a day and age when rural people are afforded the necessities of telephone and electricity, it is certainly not asking too much to expect the same from our broadcast networks. And if a satellite dish is the only way a person can receive that signal, then he/she should be allowed access. Because newspaper publishing costs and rates are up and subscriptions are down, and because many people in rural areas do not receive a major city newspaper, television has become a window on the world for those Americans. There are twenty-five million illiterate people who **cannot** read a newspaper. For them, television is their window. There are the farmers, the elderly, the physically challenged, and millions of rural Americans who, for one reason or another, live in remote and isolated areas of this vast country. For them, television is their window. Should these people be denied their First Amendment rights just because they do not live in urban or suburban areas where a television signal is received over a standard VHF antenna?

Television is no longer a frill or a luxury, but rather an essential medium that helps to ensure our free flow of information. Because of satellite technology, we people in rural America are now able to come out of that prehistoric era of television viewing and enjoy the fruits of this new and amazing technology. And our right to know, our right to that free flow of information, should be preserved and kept safe from the almighty corporate giants who would abridge those rights.

Senators, you can help us do that. . ..you can help us by quick passage of Senate Bill 889 in its entirety.

Respectfully submitted by:

Senator EXON. Thank you. The last witness, I believe, of this panel is Mr. Michael Hobbs. Mr. Hobbs, we welcome you.

STATEMENT OF MICHAEL E. HOBBS, SENIOR VICE PRESIDENT, POLICY AND PLANNING, PUBLIC BROADCASTING SERVICE

Mr. HOBBS. Thank you, Senator Exon. My name is Michael Hobbs and I am senior vice president for policy and planning of PBS.

We at PBS are proud to have worked vigorously since our earliest days to extend public television service to as many Americans as possible. We overcame enormous odds to build the first broadcast satellite network anywhere in the world, extending the television franchise to hundreds of thousands more Americans in Alaska, Hawaii, and the continental United States. In recent years our "unserved areas" policy has been extending service via satellite to tens of thousands more via cable and low power television in remote areas.

In keeping with that commitment, PBS has never scrambled any satellite transmission of our program service. We have not done so, and we have no plan to do so.

We have no quarrel at all, thus, with the objective of assuring that all Americans, wherever they may live, will have access to public television. But we are greatly concerned that the bill before you, in its effort to achieve a proper purpose, would have the unintended effect of denying real service improvements now possible through the use of digital transmission technology to satellite viewers and broadcast viewers alike.

We are planning to use that technology to install stereo audio capability system-wide, a dream that we have had in public television for 20 years. We are also working on the development of Descriptive Video Services for the blind, and multi-lingual audio tracks for the non-English-speakers in our audience.

But the technology that makes this possible—possible for us at an economical level—is precisely the same technology that the cable services are using for scrambling. If you forbid us from using that technology, you prevent us from scrambling, to be sure. But you also effectively prevent us from broadcasting in stereo and from developing these other digital audio services.

You do not need to choose between the benefits of digital audio and home dish owners' access. We have already made that choice in favor of both objectives by committing to maintaining a clear feed of every program that we transmit in stereo.

I believe that we are the only national television service that has made a public commitment to maintaining a clear satellite feed. And yet we are the only television company expressly forbidden by the bill from engaging in a practice that we have not in fact engaged in.

But the greater irony, and for the more serious concern for us, is that the bill would withhold the benefits of digital technology from all public television viewers, the two plus million home satellite viewers as well as the 200 million plus who now receive public television broadcast signals.

We urge you to delete the section that prohibits PBS from scrambling: not because we want to scramble, but because the practical effect of that section would be to freeze public television in the backwater of an obsolescent technology, and deny real benefits to home dish owners and broadcast viewers alike.

Your oversight powers, we believe, are quite adequate to assure that we abide by our commitment. And the FCC rulemaking that you provide for elsewhere in the bill is, in our judgment, a much more flexible and positive way to address a complex problem. Thank you.

[The statement follows:]

STATEMENT OF MICHAEL E. HOBBS, SENIOR VICE PRESIDENT, POLICY AND PLANNING, PUBLIC BROADCASTING SERVICE

Mr. Chairman, Members of the Subcommittee: My name is Michael E. Hobbs, and I am Senior Vice President for Policy and Planning of the Public Broadcasting Service. I am pleased to have the opportunity to appear before you today to express PBS's concerns regarding S. 889.

PBS is a private non-profit membership corporation whose members are the licensees of virtually all of the nation's public television stations. PBS provides a variety of services to its member stations, one of the most important being the distribution to them of television programming. In addition to many other pioneering technical achievements of which we are proud, PBS was the first to link television stations together by a communications satellite program delivery system. Since 1978, PBS has transmitted programming to all of its member stations via satellite.

At the outset, I would like to say once again that PBS has no plans to encrypt its regular program transmissions. On the contrary, PBS's long-standing commitment—exemplified by its "Unserved Areas Policy" adopted in 1982—has been to extend public television service as nearly as possible to all of the people of the United States, including those in rural areas who lack access to public television programming by conventional means.

Our Board of Directors in March of this year reaffirmed its commitment to continue to make a clear satellite transmission of all programs in the PBS National Program Service available throughout the country.

PBS has serious reservations regarding the new Section 705(c)(1) that S. 889 would add to the Communications Act and is opposed to its enactment. That section as drafted prohibits PBS from encrypting its satellite-delivered program transmissions. But we understand that it is also intended to prohibit PBS from encoding any of its National Program Service transmissions such that home dish owners need a decoder to view those programs, even if a clear transmission of those programs is also made available. As proposed, it would effectively prevent PBS from offering stereo audio transmissions to all 182 of its public television station members.

PBS is concerned that the bill will prevent it from realizing the full potential of its satellite distribution system and impair its ability to provide a wide range of new and innovative services to the 100 million Americans who now watch public television every week. Furthermore, it will prevent PBS from utilizing currently available technologies that would enable it to reach millions of Americans who cannot currently benefit fully from PBS programming due to visual impairments or language barriers.

To explain why this legislation will impair, rather than enhance, PBS's ability to serve the American public, let me first describe PBS's efforts to use newly-developed technologies to deliver multichannel sound to its member stations for broadcast to their viewers.

PBS, like other broadcasters, has long recognized that a weak link in the television program distribution system is the poor quality of sound reproduction. Historically, there have been a number of reasons for this. Before PBS commenced distributing programming by satellite in 1978, its programming, like commercial television network programming, was transmitted over AT&T telephone lines that were incapable of delivering high fidelity sound. That problem was solved when PBS placed its satellite system into operation.

Even before moving to satellite distribution, PBS had begun to develop its Digital Audio for Television (DATE) system to deliver high fidelity multi-channel sound to its member stations because stereo sound is especially important to public television's cultural programming. Initially, public television stations using DATE equip-

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ment re-transmitted stereo sound to their viewers by "simulcasting" programs over noncommercial FM stations; there were no systems or standards for television stations to broadcast in stereo. Then, in 1984, the FCC authorized television stations to transmit multichannel sound. PBS was instrumental in the formation of, and participated actively in the work of, the Multichannel Sound Subcommittee of the Electronic Industries Association, a group of engineering experts that developed standards for stereo sound transmission for all television broadcast stations.

Ironically, though PBS was at the forefront of the development of high quality television sound, most public broadcasting stations today cannot receive PBS's stereo broadcasts because they cannot afford to buy DATE decoders. DATE decoders cost approximately $11,000 apiece, and a typical station installation requires a minimum of two decoders (one on the air and one on stand-by). The units are custom-built for this purpose alone, so the market is quite limited, the cost is high, and replacement parts are difficult to obtain. Because of the high cost, technological obsolescence and limited availability of DATE equipment, less than half of PBS's members stations are able to receive DATE stereo transmissions today.

Due to DATE's inadequacies, PBS has been exploring new technologies to transmit multichannel sound via satellite. We have concluded that General Instrument's VideoCipher II (VC II) is the best available and affordable technology for satellite transmission of multichannel sound. By making extremely efficient use of the radio frequency spectrum allocated to satellite transmission, this technology offers the greatest protential for an increased range of services by PBS. One of those services is superior stereo sound.

The VC II technology is of vital importance to public television, for PBS considers improved stereo transmission essential to fulfilling its pre-eminent role in providing cultural programming of the highest quality—programs such as "Great Performances", "Live from Lincoln Center", and "Austin City Limits"—to the American public. Today PBS distributes about 40 hours of stereo programs a month. That number over time will continue to increase with the demand for those services.

Stereo television service recently has become more widely available through the use of both stereo television sets and videocassette recorders. Other video services, such as cable television and videocassettes, are quickly incorporating high quality stereo audio features into their services. Thus, in the coming months and years the viewing public increasingly will expect high quality audio services to accompany their television services, and if public broadcasters do not take heed of these developments they may well find their audience support adversely affected.

The promise of the VC II multichannel sound technology is by no means limited to transmission of stereo sound. The second audio channel can also be used to transmit a second language soundtrack, such as Spanish, or program annotation comments. PBS is also considering using this technology to transmit a spoken description of video portions of a television program. In that way, programming can be enhanced for blind members of the audience.

Thus, this new technology will enable PBS to reach out to large and long underserved sectors of the public who, due to visual impairments or language barriers, cannot now fully enjoy public television programming or, for that matter, most other sources of entertainment and information. Creative people in public broadcasting have always been leaders in using new technologies to improve and extend our services to the public, and we are confident that—given the opportunity—they will undoubtedly think of other valuable services that can be provided with this flexible new technology.

VC II equipment is also far less expensive and much more widely available than DATE equipment. While a typical DATE station unit would cost a minimum of $11,000, VC II commercial decoder appropriate for use at public television stations currently costs approximately $500 and can be purchased "off the shelf." Thus, the cost for on-air and back-up units of DATE equipment would cost $22,000, compared to $1,000 for comparable VC II equipment. And because the VC II has become a de facto industry standard, PBS stations can depend on its quick and continued availability, which is not the case with DATE. PBS is confident that use of this new technology will give all pbulic television stations the ability to transmit high-quality stereo programming and other multichannel services to their communities.

The concerns expressed by home dish owners that PBS might be planning to "scramble" its satellite transmissions have no doubt arisen because the VC II technology that PBS has been testing uses a digital transmission format to interleave the multichannel sound signals with the video signals. The transmissions are not encrypted. Anyone with a relatively inexpensive VC II decoder can receive the programming without obtaining prior authorization and without placing a subscription or paying for the service. PBS is exploring use of the VC II technology not as a way

of interfering with or requiring payment for reception of its program service, but rather as a way of enhancing and expanding access to its services.

Thus, PBS's use of this technology does not deny access to its National Program Service to any home dish owner. It simply requires that home dish owners wishing to receive the VC II stereo feed (instead of the clear feed) use the reception equipment necessary to receive the signal.

And, for the first time, the VC II technology will enable home dish owners in areas unserved by a public television station to receive stereo and other multichannel PBS services. In fact, the VC II is the best technology for delivering high quality stereo to home dishes.

PBS is convinced that the use of multichannel sound technologies can be of enormous benefit to the millions of Americans who view their public television stations every week. But PBS does not intend to achieve those benefits at the expense of home dish owners. We were careful to conduct our VC II tests only on special transmissions of test signals or program materials—not on regular program feeds. And in March of this year, the Executive Committee of PBS's Board of Directors reaffirmed its policy to maintain at least one clear feed of every program in the National Program Service.

In this way, PBS has attempted to strike a balance in a creative and responsible manner between fulfilling its objectives of, on the one hand, providing a program service of the highest quality to its 100 million regular viewers and improving access to that programming to the blind and foreign language speakers and, on the other hand, extending access to public television to Americans in rural areas.

PBS does not believe that S. 889 strikes a similarly appropriate balance between the needs of the viewing public in general and the special needs of home satellite dish owners. In short, this bill has the effect of sacrificing the needs of the many to the convenience of a few. It freezes PBS into an obsolescent technology, thereby seriously impairing our ability to bring a wide range of innovative services to our audience. And, while the bill has the laudable objective of assuring widespread access to public television programming, it will have the unintended effect, ironically, of denying such access to millions of Americans impeded by visual or language barriers, for the VC II is a bridge that will enable PBS to reach them.

If PBS is permitted to use the VC II technology, the only "harm" done is that the home dish owner who does not yet own a decoder will have to watch our alternate "clear" feed of programs transmitted using that system. But if we are not permitted to use this technology, its benefits will be denied to millions of viewers every day—including the rapidly increasing number of home dish owners who own decoders.

The prohibition on PBS, and its damage to our service, are severe, and are not necessary to achieve the intended benefit of this legislation. Virtually alone among the major broadcast and cable programmers and networks, PBS has made a public and unequivocal commitment to fostering the widest possible access to its programming.

Moreover, the potential "problem" that the bill is intended to forestall is likely to be a short-lived concern. Two or three years from now, most home satellite dishes will likely be equipped with decoders. Yet the legislative prohibition embodied in S. 889 risks wasting scarce resources of the public television system long after the original impetus for the legislation ceases to exist.

Transmission of a video signal uses one satellite transponder, which today costs about one million dollars or more a year. In the rapidly changing technological environment in which satellite services are provided to the public, a rigid proscription of the type embodied in this bill, without any "sunset" provision, is likely to become an outmoded and wasteful burden on the public broadcasting system faster than it could be repealed by Congress.

Not only does the prohibition specifically addressed at PBS exact a price far out of proportion to its intended purpose, but Congress does not need this legislation in order to achieve the objective of assuring widespread access to public television programming. Public television has already demonstrated its commitment to that same objective, and Congress already exercises oversight authority over the public broadcast system. That process places at Congress's disposal a highly effective means of monitoring, on an on-going basis, public television's efforts to make its programming accessible to Americans in rural areas. If Congress finds that public television does not strike an appropriate balance between the needs of its viewers for multichannel audio services and the needs of rural Americans for access to PBS programming, Congress can respond to any actual problem found to exist. At the present time, no problem exists, and no legislation is necessary.

We note also that section 4 of the proposed bill provides for an FCC rulemaking proceeding to facilitate the provision of television network signals to persons living

outside the available broadcast area of local licensees. PBS would be pleased to participate in that proceeding. We believe we could make a positive contribution to it, given our commitment and experience with our "unserved areas" policy. And we believe that would be a far less intrusive and much more equitable and positive approach than a statutory ban directed solely at PBS.

In conclusion, I urge the subcommittee to consider carefully the very stiff price which this legislation would exact of every public television viewer, urban and rural, in the form of reduced services. Thank you for giving me an opportunity to express the views of the Public Broadcasting Service. If you have any questions, I would be pleased to respond to them.

Senator EXON. Thank you very much.

Can we please come to order. I'm sure that Senator Gore will be back. He ran over to vote.

First tell me—and I suppose you, Mr. Dunham, or Mr. Ergen might be the best source of information on this—where are these decoders made? I have never seen a decoder before. I assumed a decoder was a simple little device. It doesn't look very simple to me. It looks more like a VCR.

But where are these devices primarily made that are being sold today, and what is the approximate going price? I have been led to believe it is somewhere in the $400 area, give or take. Where are they made and what is the approximate retail price?

Mr. DUNHAM. Senator Exon, if I might I will be happy to take you through the products here and their prices and place of manufacture.

This is a descrambler module. This descrambler module is manufactured in the U.S. possessions, Puerto Rico. This module is the guts, if you will, of the descrambling process. This descrambler module plugs into two types of products. One type of product is a stand-alone descrambler, which was designed primarily to serve the people that have already purchased receivers, already have a satellite dish. When the service that they want scrambles they can buy this and upgrade their system. This module plugs into the back of that chassis.

The chassis originally was manufactured by Hitachi under subcontract. It is now in Korea, and we're starting up a General Instrument facility in the Maquiladora program in Mexico, across the border from El Paso.

The module also plugs into what is called an integrated receiver descrambler.

Senator EXON. Where is the module made?

Mr. DUNHAM. It's made in Puerto Rico.

Senator EXON. So that the layman can understand this, does that module have to be used on any of this equipment that I see before me or not?

Mr. DUNHAM. Yes, that is correct.

Oh, I should make a correction, sir. We have a licensee, Channel Master, which manufactures this module in their factory in Smithville, North Carolina. They are a competitive manufacturer for this module.

Senator EXON. So you have really two, one in Puerto Rico and one in New Jersey?

Mr. DUNHAM. No, North Carolina. Smithville, North Carolina.

Senator EXON. Okay. Thank you.

Mr. DUNHAM. Just to continue, the integrated receiver descrambler effectively combines the function of the satellite receiver and the descrambler. This module is sold to 16 IRD licensees. I think there are seven that are actually taking product today and that are shipping product into the marketplace.

This descrambler module sells for $150. I think there has been some confusion over the $400 unit. This unit here is a $395 suggested retail price. You've heard—I know that I have gotten a lot of phone calls that this unit is being sold for more out in the industry today. Unfortunately, that is a fact. As a matter of fact, Mr. Ergen could probably attest to that because yesterday I had my staff call Mr. Ergen, and it's selling for $399 at Mr. Ergen's warehouse.

This unit has a suggested retail of $395. That $399 price that Mr. Ergen is charging to the dealer, he has to sell that to a consumer that has seen a $395 suggested retail price. He has to sell it to a consumer that has seen ads like this which Mr. Ergen has run. It says, $299, the bottom just dropped out of the Videocipher 2100 price.

If you could see this little line right here——

Senator EXON. I can't, but read it.

Mr. DUNHAM. I can read it. "With purchase of selected programming." When we called and inquired about their $299 decoder, the message we got is that you can buy an HBO and I think Cinemax package, the total package is only $619. Or if you only want Cinemax and CNN you can get it for $519.

There are other distributors who have raised prices also. As a matter of fact, at the House hearing Congressman Tauzin held up an invoice for $500 and some odd dollars from a full line distributor. What has happened is that some distributors, depending upon their avarice if you will, have, due to the shortage, raised their prices.

General Instruments has not raised their prices during this shortage situation. We absolutely have not and we do not intend to. But we have ended up getting the brunt of these charges on the pricing going up because of the distribution network which we have no control over. We give a suggested retail price, but under law we're not allowed to force them to sell it for any price. They can sell it for whatever they want. I think the law insists that we do that.

So getting back to the products themselves, the integrated receiver descrambler, it really varies, Senator, based upon the features that are included. There are some units—Mr. Ergen has one that is the top of the line. There are some units that are in the middle of the line. Then you have your low end.

The retail price I think is probably in the ballpark of $1,400 for top of the line, maybe down to $799 or $800 for the lower end. It just depends upon the features. There are 16 manufacturers. They all have different features.

Senator EXON. The last part of my question—We'll get back to you, Mr. Ergen. I think you should have a chance to respond. Then, Mr. Chairman, I'll turn it back to you.

Where are the rest of these products made? Do you know?

Mr. DUNHAM. It varies, sir. I think there are probably four to five manufacturing sites. I do think a large number of them are in the Far East. At this point it is just the most cost effective way.

Senator EXON. It wouldn't be unusual because all of these products are made outside of the United States of America today. That is a very sad situation, but I suspect that are the competitive forces under which we are working today. That is all part and parcel of our trade deficit we're concerned about.

I guess it does concern me a little bit more that we have a new industry that I complimented earlier in providing a great array of programming. But by the same token, this new exciting series of programming to bring information supposedly to every American household relies upon further escalation of our trade deficit to get that program in. I think that is a side factor on this. It probably isn't overall good for America.

I'll have some other comments later. But I think, Mr. Chairman, with your permission, we'll go to Mr. Ergen because I suspect he wants to reply to the statements that have been made by Mr. Dunham, unless I misinterpreted the expression on his face.

Mr. ERGEN. Thank you, Senator Exon. I want to correct Mr. Dunham. He seems to be confused with the facts.

Number one, he did raise Ecosphere Corporation's price in May of 1987 this year during the peak of the shortage by approximately 4 percent, costing Ecosphere about $600,000 for the life of our purchase order at that time. I have the facts to document that for you.

Secondly, Ecosphere's price—I just happen to have one of my price sheets here. For a stand-alone decoder, range from $299 with the purchase of a satellite or certain receivers that haven't been able to be sold in the marketplace because they haven't been able to get stand-alone decoders. We're helping those manufacturers out. It goes to as high as $399.

My cost in Denver, Colorado is approximately $325. I actually lose $26 when I sell it with some of my manufacturer's product. I make a maximum of 20 percent profit if you buy just a single stand-alone decoder during the shortage situation.

Now, what I think I heard Mr. Dunham do was accuse me of gouging. But the initials GI in our industry stand for Gouging Instruments. The General, an article that was published in Forbes Magazine just several weeks ago, has a picture of Mr. Dunham smiling, talking about the monopoly power that he has and the profits that he's making.

He makes a 35 percent profit margin after expenses according to this article. That is two or three times higher than the normal rate and ten to fifteen times higher than he expects his dealers and distributors to make on this product. Who is gouging who here in the marketplace?

Senator GORE. Did you want to respond, Mr. Dunham?

Mr. DUNHAM. Yes, sir. I would like to respond. I would like to welcome you to the Larry and Charlie show.

Charlie and I are on the board of directors of the trade association. We have had these type debates now at probably three board meetings, once in Las Vegas, in San Diego, and also in Alexandria, Virginia. It's a constant debate going back and forth about whether Charlie has been mistreated and if he's getting enough product.

I came to this hearing today—as you noticed in my introductory statements I did not get aggressive toward Mr. Ergen. Mr. Ergen is noted in this industry as a very capable aggressive businessman. He is probably one of the most successful businessmen in this industry. I actually commend Charlie. He is one of the most astute, sharpest businessmen that I have ever known.

Mr. ERGEN. I agree with you totally, Mr. Dunham.

Mr. DUNHAM. However, if you might let me continue, Charlie. If you look at this document that Mr. Ergen filed here, which is at least an inch and a half thick, there is one motive and one basis for this document. That is because Mr. Ergen wants to have a license to build a Videocipher.

We have already licensed Channel Master. We have capacity between us that is double what this industry reached at the peak in 1985. We have a very large investment. I asked Mr. Ergen where was he four and a half years ago when we started the development of this program?

As a matter of fact, an interesting point for his gouging comments. If you take General Instrument, the Videocipher program, from back in 1982 when we started developing this product, and you take the cumulative losses of that program, we were losing up to a million dollars a month until finally sometime in 1986 when we broke even or made a profit.

If you take the cumulative profit since sometime in 1986 and you add it against the losses, we're in a cumulative loss situation since the inception of this program. Mr. Ergen got involved in the Videocipher program last year, in 1986. He has received 23 percent of all stand-alone descramblers. That's in excess of 50,000 stand-alone descramblers.

In his testimony he claims that we are taking unfair advantage of the other manufacturers, the other 16 manufacturers, that we're just taking advantage of them. Mr. Ergen has received 58 percent of all IRD modules. Mr. Ergen's IRD was the first on the marketplace. We had some start-up problems and our product slipped. If we were trying to compete unfairly I wouldn't have shipped modules to Mr. Ergen.

I shipped 58 percent to this gentleman next to me. If you take just the margins on the product that we've shipped him, he's made millions of dollars in margin on this product based upon his public pricing. I just think it is unfair that the group of people in San Diego that have a technology developed and protected under patent law, that we have Mr. Ergen who comes in 1986 when this market finally comes together after four and a half years of putting my life and a team together to try to pull this thing together, that he comes in and it's absolutely imperative that we license him.

Licensing Mr. Ergen isn't the issue. Licensing Mr. Ergen will not help the short term demand situation. The realities of manufacturing will not allow that. It would be at least six to nine months before he would have product out there. By that point in time the combined capacity of Channel Master and General Instruments will be in place.

Senator GORE. Mr. Dunham, the subcommittee is not interested in the dispute between two companies in this business. We're inter-

ested in the effect on the consumer. The consumer is not having a very good time of it with these Videociphers.

They're hard to find. They're way over-priced compared to what the promises were. How can it be straightened out if you're opposed to this legislation? How can it be straightened out in your view? I'm going to do my best to pass this legislation. What is your recommendation? Do you believe the marketplace is working well now?

Mr. DUNHAM. Mr. Chairman, as I pointed out in my introductory comments, the single largest issue right now is supply that does not meet the demand. That supply shortage came about, it really started evidencing itself this spring. The demand really started picking up in the February to March timeframe of this year.

In November of last year we had Anixter, which had placed a $15 million order for 50,000 units. They had almost 20,000 units in inventory in November. As a matter of fact, they cancelled the baiance of their contract. They cancelled the remaining 25,000. Channel Master had about 30,000 in inventory.

So as recently as November we were in an excess inventory situation. If you look at the chart that I have on the board, the line going straight up is the number of consumer descramblers that are authorized. The blocks underneath are the number of consumer descramblers that are authorized on a monthly basis.

I'd like to point you to October when Selec-TV—across the bottom you can see the timing of when programmers scrambled and what impact it had on authorizations. When Selec-TV scrambled in October, the authorizations and consumers purchasing descramblers went up very dramatically. It jumped right up to 17,000 from the prior month of 9,000.

That was primarily because HBO, Showtime, Movie Channel had already scrambled. They were the last movie service to go, at least that's what we think caused that jump. After that you can see that the trend started going back down again. If you look in the November to December timeframe which is when we were placing long lead materials orders with our vendors in the Far East—there is a six month delivery cycle here—I had one of my major customers just cut his 50,000 unit order in half. We also had declining authorizations.

Mr. Ergen was not there at that point in time asking me to build more units for July or August, I assure you. If you look at what happened, we actually ordered long lead materials twice what the authorization rate was in November and December. I thought I was being very aggressive as the person responsible for the P&L of that division. Authorizations were going down, inventory was up, it's uncertain as heck. You didn't know whether there was going to be legislation. The programmers kept moving their scrambling plans.

I placed materials for twice the amount of descramblers that were being authorized on a monthly basis. I think in retrospect I missed the market there. It surprised, a lot of people in the industry. It really gets back to if the market isn't working, where is this demand for these 400,000 descramblers that I have on order right now? Why can't I supply it if it's not working?

Senator GORE. As I listen to you, I am reminded of—I don't want this to come out wrong—but it sounds almost like one of the expla-

nations in Russia why a five year plan went wrong. What I mean by that is, when you have a single supplier trying to anticipate all of the movements in the marketplace and all of the dynamism of supply and demand, it's almost impossible, no matter what your intentions, no matter what your motives.

You could have the best motives and intentions in the world, but if there's no competition and there's only a single supplier, it's like that old five year plan.

Mr. DUNHAM. Mr. Chairman, I'd like to explain that we do have competition. As I stated—I don't think you were in the room—we have 16 licensees for the integrated receiver descramblers here. They are a barometer of the market. They place module orders with us. They also place module orders with our competitive licensee, Channel Master.

So we did license the module and we have licensed the 16 manufacturers. The license and fees for the IRD is $2,500 plus 25¢ per unit.

Senator GORE. But all of those 16 have to buy the module from you, right?

Mr. DUNHAM. No. They have a choice. They can buy the module from Channel Master or they can buy the module from General Instrument. Mr. Ergen is going to take exception to that because we——

Senator GORE. You license Channel Master, right?

Mr. DUNHAM. We license Channel Master.

Senator GORE. How many has Channel Master made?

Mr. DUNHAM. That's what Mr. Ergen would take exception with.

Senator GORE. Just answer the question. I don't want to get into your personal argument. I don't care about that. How many have you made and how many has Channel Master made?

Mr. DUNHAM. Channel Master started manufacturing units in February of this year. They started manufacturing units and they have been going through a ramp up. I don't know——

Senator GORE. How many have they made?

Mr. DUNHAM. I can't give you a precise number. I know they're up to about 10,000 a month at this time. So 10,000, if I back up, I would say something into the 30,000 to 50,000 range.

Senator GORE. And how many have you made?

Mr. DUNHAM. Total modules probably 300,000.

Senator GORE. Okay.

Ms. DAVIS. Senator Gore? Can I speak from a consumer angle?

Senator GORE. Yes, please.

Ms. DAVIS. First of all, that chart really doesn't make me feel that good. All I know is that the price is high. They're arguing about whether it's $300 or $400. The way I feel is that if this bill were to pass and we were to have a standard encryption system, it would open up the marketplace and nobody would have to argue about whether somebody was gouging somebody because like a VCR with the VHS system, you could go out and you could shop around and find the one that is going to fit your pocketbook.

Personally, I cannot afford an IRD. My husband is a teacher in Arkansas. I don't work. We have a daughter in college, and I can't afford $1,000 or $1,100 for an IRD, which is what my dealer quoted me. Furthermore, every week when I happen to go to town, if I

happen to stop and say hi to Rodney, my dealer, it's gotten to be a joke because I say well, what are the VC II's up to this week, Rodney? He says, well, they've probably gone up again but I really wouldn't know since I don't have one in the store.

All these people are arguing, Senator Gore. Like I said in my speech, they all have answers to everything and solutions to nothing, and the consumer is getting tired. We want to see some solutions. We're tired of this. I've been battling this for two years.

Senator GORE. Well, I've been in it for longer than that. I'm hopeful that we're going to really pass this legislation this year. I think it's very significant that Chairman Hollings has joined as a co-sponsor. I think it's very significant that several Senators who voted against the legislation last time have now said look, we've given the marketplace time to work and there is still chaos in the marketplace, and the consumers are still not being served.

Rural America is still being discriminated against. Satellite dish owners are still getting a raw deal. When this legislation comes up this time I think you're going to see a different outcome than last year. I'm really very optimistic about it.

Ms. DAVIS. Senator Gore?

Senator GORE. Go ahead.

Ms. DAVIS. I just want to say consumerism is the bottom line here. These guys seem to forget, if it weren't for us they wouldn't exist.

Senator GORE. It's consumerism and also small business because a lot of the people that got into this business were entrepreneurs and were trying to get involved with an exciting new technology and service. Then they encountered some of the big powerful interests that had other plans.

But let me move on. We're going to change that.

Mr. ERGEN. Senator Gore, unless you're going to ask me a question, I would like to respond to Mr. Dunham's response.

Senator GORE. Well, we're not going to continue this indefinitely. If you can give a very brief response.

Mr. ERGEN. Yes, I can. First of all, let me point out that I represent distributors and manufacturers. While Mr. Dunham may personally attack me, I'm here not to present only Ecosphere but also all consumers and manufacturers.

The key point here is that Mr. Dunham says he was unaware of the demand, or General Instruments was unaware of the demand. I have records that I have of communications with them starting in January of this year, increasing my order within the 120 day lead time, warning them of the impending shortages that were coming up.

As a national distributor and also a distributor of many manufacturer's products, we were able to see in the marketplace this increased demand. My orders were actually termed unrealistic in a letter to our trade association, but I kept trying to get them information. I asked to license the product if they wouldn't actually go out and produce it.

I gave them plenty of notice. I think other people in the industry also gave them plenty of notice. In fact, in February I received a letter from them stating that they were having increased demand.

They had capacity of 50,000 units. They were producing at less than 20,000 units a month.

The shortage happened for one reason in my opinion. It enabled General Instruments to increase their market share in their IRD receiver. They make a certain amount of profit on this module. They make a certain amount of profit on this stand-alone decoder. But they make an additional profit, maybe another $200 or $300 profit, on an IRD receiver.

If the consumer who owns a satellite dish out there already owns the receiver and he can't get a decoder, of which they have no competition contrary to what he said—they are the sole source—then his only choice is to buy a higher priced IRD receiver. If he's a new consumer and he wants to get a descrambler, his only choice was to buy an IRD receiver.

In a Los Angeles Times article that was printed just last week in a San Diego paper, General Instruments, through their PR department, indicated that they had a 25 percent market share in the IRD receiver market, and they expected that to increase to 50 percent market share.

I contend that this could not have been accomplished had they produced the orders that they were getting for the stand-alone decoder. So Mr. Dunham says if the shortage goes away there is no problem. That is not the case. We still have improper allocation of General Instrument resources. We still have very little competition if we want to design a new product or my competitor wants to design a new product. We still have whatever price he wants to charge out there in the marketplace.

He still controls the three chips that he sells to Channel Master, so he can raise the price of those chips to Channel Master, or he can suddenly be out of stock for Channel Master so that they can't compete. I think what I'm concerned about and what other manufacturers are concerned about is that they have a legal patent we think, assuming its a legal patent, on about three chips, about this size, three chips.

And they should make a profit on these three chips and they should get a return on their investment for these three chips. But they shouldn't be allowed to use this patented technology to gain market share in modules after they promised they would license them to all parties that were interested. They shouldn't be allowed to gain profit on stand-alone decoders, which can be built for $100 cheaper for the consumer here.

They shouldn't be allowed to gain market share as a result of profits on their own stand-alone decoder, except that they went it in free market competition. That's what we're here about.

Senator GORE. You and the equipment dealers and distributors support the legislation, S. 889. Correct?

Mr. ERGEN. Yes we do.

Senator GORE. All right. We're going to have to move into some other areas before we conclude here. On PBS——

Mr. DUNHAM. Mr. Chairman?

Senator GORE. We will come back to you in a moment, Mr. Dunham. I'm sorry. We're just going to have to—I'm sorry. We can't——

Senator EXON. Mr. Chairman, if I might. I might tell the witnesses that you're here as witnesses——

Senator GORE. To respond to questions. That's right.

Senator EXON. To respond to questions. I for one did not come here to listen to an on-going debate that I feel contributes very little to the bill itself. I have several questions. I'm not going to stay here all afternoon listening to debates. I would hope that we could move this along.

Senator GORE. We're going to.

Senator EXON. I think we tried to be fair to Mr. Dunham. I think we tried to be fair to Mr. Ergen and all the panel. But we've got to move along because there are a few other responsibilities that we have here, other than this very important matter. Thank you, Mr. Chairman.

Senator GORE. On PBS, on this matter, Mr. Hobbs, I'll just briefly note that my staff and I have had several discussions with you about PBS' plans to scramble. I understand the reasons you're giving as choosing the Videocipher as a delivery mechanism for audio/stereo programming to your affiliates. And I understand and appreciate your efforts to keep programming unencoded through an alternative delivery system.

You're making that commitment, right?

Mr. HOBBS. Yes indeed, Mr. Chairman.

Senator GORE. So somebody that doesn't have a Videocipher and doesn't get the stereo version of it will get the unencoded monaural version of it. Correct?

Mr. HOBBS. We are very eager, Mr. Chairman, to provide the benefits that we see in the use of digital stereo transmission for our programming, not only for those who watch on broadcast public television stations, but for those who watch on home satellite dishes as well.

We recognize, however, that with the lag in the supply, for whatever reasons, in the availability of home decoders, that if we were to employ that same technology for the use of stereo transmission and do nothing else, then home satellite viewers would not be able to receive that stereo programming or indeed receive it at all.

So we have addressed this as a matter of policy, reviewed and adopted by our Board of Directors as recently as this March, because of the concerns that had been expressed. We have made the public commitment to maintaining a clear satellite transmission of every program in the PBS National Program Service. Yes, sir.

Senator GORE. That's very good. Also, to clarify the reason you went to the Videocipher II for your stereo signal, that was not in order to exclude viewers. It was in order to use that technology in order to get your stereo signal there. Is that what you're saying?

Mr. HOBBS. Yes indeed. We've been trying for many years to develop—Indeed, our PBS Engineering Department developed and I think received some engineering awards for one of the first digital audio transmission services, which we call DATE (for "digital audio for television"), more than a dozen years ago now.

But that equipment was something that we designed specifically for that purpose. There was no public market for it. It is still available to some extent today. But because it is a single purpose tech-

nology, it is prohibitively expensive compared to the obvious mass market price advantages of this Videocipher digital equipment.

We can do a typical station installation for using the VC II system to transmit stereo for about $1,000. The units are a little more expensive than the consumer units. They have some professional aspects to them as well. A comparable DATE installation would run each of our stations on the order of $22,000, largely because they are custom units. And even once you have that equipment you can't get replacement parts for it.

Senator GORE. Okay. But you're going to keep a clear signal unscrambled for all of your programming.

Mr. HOBBS. We've heard a lot this morning about the clash of economic interests.

Senator GORE. You don't have one.

Mr. HOBBS. Our economic interest is in having as many people as possible watching public television.

Senator GORE. Well, good for you. Now, if somebody at home has a Videocipher II and wants to pick up your stereo audio signal, they can do so without any charge other than the expense of the equipment. There is no monthly charge anticipated. That is restating the obvious, but just to reconfirm that for me if you will.

Mr. HOBBS. That is correct. We distinguished in our policy between what we called encrypting, which is something that would require intervention by PBS or by somebody else to authorize the home viewer to receive the signal in an unscrambled fashion, or encoding, which is what we propose to do with our audio signal.

If it's merely encoded, that means that anyone who owns the home decoder can view the program in the normal way and indeed have the advantage of the stereo transmission as well.

Senator GORE. All right. Now Mr. Timothy, I am pleased that NBC has no plans to scramble. Have I mistated that?

Mr. TIMOTHY. Yes. We have plans to scramble down the road. Yes, sir.

Senator GORE. Sometime down the road. You have no immediate plans.

Mr. TIMOTHY. Yes.

Senator GORE. Well, the Netlink—I wanted to ask you about the Netlink plan. It seems to be a start toward serving dish owners in hard to reach places. But I'm concerned that Netlink may not be offered in a fair and non-discriminatory way since the principle owner is TCI, a large MSO, multi-system cable operator.

Will Netlink be made available to non-cable distributors such as NRTC, Amway, Home Satellite Services, etc.?

Mr. TIMOTHY. Yes, sir. It is, as you indicated, a start. It is a non-exclusive arrangement that we have with Netlink and TCI—We might make arrangements with others to provide the service. It's not exclusive to TCI and Netlink.

Senator GORE. It will be made available to non-cable distributors?

Mr. TIMOTHY. Yes, sir, the Netlink agreement is not cable exclusive.

Senator GORE. If a dish owner lives in a cable franchised area but does not get cable or is within a so-called Grade B Contour, will he be able to subscribe to cable?

Mr. TIMOTHY. Will he be able to subscribe to cable, sir?

Senator GORE. To Netlink I mean.

Mr. TIMOTHY. If in the situation you pose the viewer can now receive the network service through the traditional means, i.e. from an affiliate station or through a cable system, then the answer to your question is no. The Netlink arrangement is not available to that satellite dish owner.

Senator GORE. What if the customer is in a Grade B Contour but nevertheless cannot receive the signal? There are a whole lot of people in Tennessee who are in that situation.

Mr. TIMOTHY. That's fine. The criteria is whether or not the viewer can receive or not our signal.

Senator GORE. Who makes the determination?

Mr. TIMOTHY. In conjunction with the cable system, (possibly TCI in this case who is looking at it), and our local affiliate as well.

Senator GORE. What if the dish owner is in a cable franchised area but is not served by cable? In other words, you're familiar with that situation. There are a whole lot of folks who are in an area that the cable company says at some point in the future we have plans to possibly serve this area. But they don't get cable. Will they be able to subscribe to Netlink?

Mr. TIMOTHY. Yes, sir.

Senator GORE. All right. Well, those are positive responses, and I appreciate that.

I'm going to give you one brief chance to respond, Mr. Dunham, if you'll keep it very very brief. I didn't want to cut you off prematurely. Very brief though, please, because we're going to have to close the hearing down.

Mr. DUNHAM. Mr. Chairman, first I apologize for the conflict.

Senator GORE. That's all right. Go ahead.

Mr. DUNHAM. I would like to correct one statement for the record. That was that the trade association supported the FCC mandated standard. I am a member of the board of directors of that association. As I recall, the official position is that they do not support that aspect of the legislation.

The SBCA, does not support FCC mandated standards, primarily because all the businessmen that belong to the association are concerned about confusion in the market and hampering the recovery of the marketplace.

Senator GORE. Senator Exon.

Senator EXON. Thank you, Mr. Chairman.

Mr. Dunham, to get back to this cost matter. I listened very carefully to your testimony and as near as I can tell from what I've heard in this hearing, the cost of these products have not come down because, if I understand you correctly, there is a kind of general unsettled condition in the marketplace today, who is going to do what. Therefore, the demand, according to your statement, has not increased as much as you anticipated that it would have. Is that a general fair summary of what you've said?

Mr. DUNHAM. Sir, the first part I followed. The last part I missed.

Senator EXON. Let me ask you this question. I didn't hear it from you but I heard it from many other sources a year ago that by this time, a year later, descramblers would no longer be in short

supply, that there would be many of them and the prices would fall. The fact of the matter is it's a year later now and the prices have not fallen.

One of the reasons that this bill did not pass a year ago, I would suggest to the Chairman, is the fact that there were some of us who said well, let the marketplace work its will. If within a year or some reasonable time the price would fall to the $100 area, to use Ms. Davis' suggestion, or somewhere in that area, then there was no need for legislation.

The fact of the matter is that the retail and/or the wholesale price of these descramblers has not fallen in the last year, have they?

Mr. DUNHAM. Yes, sir. That is a correct statement.

Senator EXON. If anything, they've generally gone up.

Mr. DUNHAM. As a matter of fact the retail price has actually gone up in recent months. The wholesale price has held stable. I would like to just comment on that price, how it was arrived at.

Three or four years ago when we were working to convince the programmers in the industry that the Videocipher system was the appropriate standard, at that point in time the stand-alone descrambler—I would just like to make the point this chassis which goes around the descrambler board is two-thirds of a receiver.

The reason you require two-thirds the electronics of a normal satellite receiver is that the programmers insisted that General Instruments design this product such that it would be compatible with at least 90 percent of the existing base out there. The original design we had which was compatible with Macom products was actually a bit cheaper, but it was not compatible with all the 70 megahertz products.

So based upon input from the programmers we designed this unit to be 90 percent compatible. One final point, this is a very complex piece of equipment, and the question is why hasn't the price come down with the volume, etc.

In order to get the original contract with the programmers, it was a very intensive competitive battle between us, Scientific Atlanta and other manufacturers. We were actually competing by offering the programmers a price that we were going to sell the product for.

This product, which is very similar to a VCR in technology, as I said it's retail price right now is $395. If you would recall when VCR's came into the marketplace, they were priced anywhere from $1,000 to $1,500. You can buy one now for $250. Probably 30 or 40 million of those have been sold, and over a period of time that original price came down.

Forward pricing means that we project forward a significant volume and establish a constant price over that large quantity. We actually have less margin up front as we come down the cost curve. You try to go across a point where it levels out the impact of the recovery of your investment.

As an example, if we had not forward priced, it would have been offered initially at $1,000 to recover costs. It may have gotten down into the $200 range after you got over the initial volume.

Senator EXON. I don't mean to cut you off, but I guess I have never been through a hearing such as this one, Mr. Chairman. I've been around here a long time. Now, please answer my question.

Was I told erroneously a year ago that the price would likely be coming down? It's clear to me that the price of this unit is not going to come down until the wholesale price comes down. You've got a patent on this and you've got a right to sell that any way you want and market it any way you want, and I don't want to interfere with that. I just want a simple answer to the question.

Was I incorrectly informed, and others like me a year ago, when we were told that there would be a drop in the cost to the consumers? The consumers aren't interested in how much Mr. Ergen makes or how much you make. What they're interested in of course is paying a reasonable price, and they're willing to pay a reasonable price. They aren't thieves. They aren't trying to steal anything.

They're willing to pay a reasonable price for a decoder. I was misinformed, was I not, a year ago when I was informed that by this time there would be a drop in the price of these instruments?

Mr. DUNHAM. Senator Exon, I did not testify at that, but I do have a general idea what was said. I think it has been misinterpreted by several other people in that the price of the descrambling function would come down with the introduction of the integrated receiver descramblers because by purchasing the descrambler module for $150 with the costs associated with that to integrate it in, the effective cost to the consumer, depending upon how the manufacturer prices it, would be somewhere between $175 to $200.

This is really the same function. I think that was the part of the testimony that said the effective price of descrambling would be coming down. That has happened because IRD's, integrated receiver descramblers, were not on the marketplace this time last year. They were not. The only product that was on the market was a stand-alone descrambler for $395.

Senator EXON. Let's not get into all the technical details that can confuse most of us. Let's say that I am in an extremely rural area of Nebraska or Arkansas and I have a dish out there and all at once they start scrambling my programs. A year ago, how much money would it have cost me to buy an instrument that would have allowed me to watch the program as I did before scrambling started? How much would it have cost me?

Mr. DUNHAM. If you had an existing system it would be the suggested retail, which was $395.

Senator GORE. That's the actual retail.

Mr. DUNHAM. At point in time I think it was $395. I know we were selling direct. There were several direct sales outlets that were selling at $395.

Senator EXON. So let's say $400. What is it today?

Mr. DUNHAM. The market price for the stand-alone unit today, as I mentioned before, it ranges anywhere from $400—I had one invoice at the last hearing that was for $585. I think it varies.

Senator GORE. What's the average?

Mr. DUNHAM. I would guess it is probably $450, sir.

Senator EXON. So it hasn't come down. We've established that. What I'm trying to do is establish the fact that in the last year the

price of a descrambler that will work on most of the satellite dishes today has not gone down. If anything, it has gone up in price.

Mr. DUNHAM. Yes, that is correct.

Senator EXON. Mr. Chairman, that indicates to me that whatever the language was used—and it wasn't from you, Mr. Dunham. But I think at least there is testimony on record, and at least this Senator was led to believe that the economies of scale would take over, these things would be available and it would be down to a reasonably priced area. I don't know what a reasonably priced area was, but from the discussion I gathered that was around $100. I think Ms. Davis and someone similarly situated would be willing to pay that.

I'm not sure they're willing to pay $400 or $500, especially with the undecided situation that we're in right now.

Thank you for coming. I hope I haven't been too brusque with you because I've spent a lot of time listening because this is a key issue, I think, that we have to discharge here.

I appreciate your consideration, Mr. Chairman.

Senator GORE. We have had a very long day today.

Ms. DAVIS. Mr. Chairman?

Senator GORE. Ms. Davis, if you can keep it brief, please. Please. Go ahead.

Ms. DAVIS. Sir, with all due respect, I've travelled 1,000 miles. There have been many great people across this country that have helped me get here.

Senator GORE. You're most welcome to speak up, Ms. Davis. Go right ahead.

Ms. DAVIS. I have some real problems here and I haven't been able to address them. I'll try to keep it as brief as possible.

Senator GORE. Did you have a chance to testify when I was voting?

Senator EXON. Yes, she did.

Senator GORE. All right. Please go ahead and speak again.

Ms. DAVIS. Well, I gave my oral testimony. You weren't here.

Senator GORE. That would be fine. Go right ahead.

Ms. DAVIS. Okay, I'll try to be as brief as possible.

I am not technically adept. He talks about data and all that stuff. What I know is that I've paid for four feeds. If they have sensitive material, they can scramble that. But I don't believe that Public Broadcast has a right to scramble its feeds.

If they really have the public's interests at heart, then they should be supporting this bill. NBC, they have stereo. They don't have to scramble. I believe that there should be a way where people shouldn't have to buy a decoder either to be able to get PBS.

As far as the networks which is really my pet area, and you probably know that, I have a real problem here with this because first of all, just for the record, I do not believe the networks have a right to scramble. I think they're getting hysterical about their affiliate relationship. I have things in my written testimony, Senator Gore, if you will look that shows that bypassing the affiliates is a fantasy on their part.

If I could get my affiliates I would love to just so I would know what goes on in Arkansas. I think they're over reacting. They're using our public airways to reap healthy profits, and now they're

going to scramble. And what are they going to do? They're going to let a cable company police us. We're going to have to pay this monopoly whatever price is determined.

This gentleman from NBC stated that he would deal with others. Of course, you understand, first of all, I don't believe they should scramble. Second, I don't think that we should have to pay for NBC when nobody else in America does because we've already paid for it by going to the marketplace. Now we're going to pay twice.

To add insult to injury, we're going to have to deal with a monopoly. I find this whole thing very murky, Senator Gore. I think this needs to be looked into a lot more. We have maintained if they want to scramble their raw feeds, we understand that. We're not saying anything about that. We ask that they leave front hall prime time feeds in the clear intact with national advertising.

That's all we ask If this bill—I shouldn't say if. When this bill goes to mark-up and it is passed in its entirety, rather than to let the FCC handle this network problem, which is like the fox guarding the henhouse, I would really like to see that whole area changed and ask that these networks transmit in a front hall prime time feed. I really don't believe for one minute—and I've talked to a lot of people—that they have any problem with their affiliates.

NBC did a survey themselves showing that the majority of people prefer local newscasts over network newscasts. Even Jack Lease—I've got a quote here—who is vice president of programming at the NBC affiliate in Atlanta, which is being uplinked by SBN, he said saleswise they haven't been affected.

Dishes have been around for several years. The affiliates don't seem to be hurting. That's all I have to say. But I really wish that you people would really consider what's happening here with our public airwaves and these networks. They're an oligopoly.

Thank you.

Senator GORE. Very good. I appreciate your statement and the forceful way in which you deliver it. I think that's a very good statement.

I wanted to clear up one thing. Mr. Hobbs said earlier that he's going to make sure that you will be able to get the PBS signal unscrambled.

Ms. DAVIS. One feed, right? And who is going to determine what programming we get? They keep talking about the national programming service. Nobody seems to know who this is or what programming is going to be made available.

Senator GORE. What he's saying is—I'm with you and I want to tie down this commitment. If you have doubts about this commitment, let's clarify it.

Mr. Hobbs, you're committing to making certain that Ms. Davis has an unscrambled PBS signal. Correct?

Mr. HOBBS. Any program that any home dish owner and viewer can now view on public television on the PBS program service will continue to be available as it is now.

Senator EXON. What about new programs that you might come out with?

Mr. HOBBS. Anything that we would ordinarily be providing for public viewing by retransmission by our public television stations

nationwide is going to be going over the satellite. We're saying that if we're sending any of that in stereo using this technology to get the stereo inexpensively to the stations, and to home dish viewers for that matter, we will also continue to make it available on at least one clean feed for every program so that there is no program that is unavailable to a home dish owner because of the fact that it has been digitally encoded.

Senator GORE. That sounds like a pretty good commitment to me, Ms. Davis. Why is that—do you have reservations about that?

Ms. DAVIS. I have reservations anytime a public broadcast station feels it needs to scramble to produce something——

Senator GORE. But you're going to see——

Ms. DAVIS. Does that include Live From Kennedy Center and all the future upcoming concerts and programming? They talk about user financed programs——

Senator GORE. What I'm hearing him say is that it includes any program, present or future, that is to be broadcast to any public television outlet anywhere in the United States. It will be available for home dish owners unscrambled.

Ms. DAVIS. But isn't it true that we pay for all four feeds, Senator? Why is a public broadcast station being allowed to scramble? Are they going to become a fourth network?

Senator GORE. You can only watch one at a time.

Ms. DAVIS. That isn't the point. My taxes are paying for all four.

Senator GORE. All right. Well, I understand. As for the other, we are going to take very close account of your testimony here. That is one of the matters that is under review as we consider this legislation. Senator Bumpers and Senator Ford and I are working very hard on it.

I would like to say in concluding this hearing that I am appreciative to all of our witnesses because we have had a long day, going from 9:30 this morning until 2:15 this afternoon. I think we've had very good testimony.

As we have heard from some of the Senators here, many of our colleagues who were willing to go the extra mile and give the marketplace a chance to operate and listen to the pledges from those in the industry who said with a little more time this will work out, just give us another year, a little more time—these pledges coming on the eve of the vote last year of course—now we've had the extra time, we've seen what's developed in the marketplace.

The situation is no better than it was before. In some ways it's worse. The price of the descrambler has gone up. The availability problems have gotten worse. There is still no competition at all among third party distributors of program packages that would allow the supply and demand forces to work and allow the marketplace to work.

So I am extremely optimistic that with our additional cosponsors and with the additional support for this legislation and with the momentum being built up on the House side as well, I'm very optimistic that we're going to pass this legislation this year.

The hearing is adjourned.

[Whereupon, at 2:13 p.m., the subcommittee hearing was concluded.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. GEORGE J. MITCHELL, U.S. SENATOR FROM MAINE

In the 100th Congress, I am pleased to have joined Senator Ford, Senator Gore, Senator Bumpers and nine other of my colleagues as a co-sponsor of S. 889, the "Satellite Television Fair Marketing Act."

It is the second year in the row that I have supported such legislation.

Congress needs to act to protect the rights of satellite dish television viewers. Such legislation was necessary in early 1986, when many cable television programmers began scrambling their satellite transmissions. And it is still necessary today.

I have received hundreds of letters from Maine citizens who are owners of satellite receiver dishes. For many Maine families, satellite dishes represent the only access to television.

In Maine, many communities lie beyond the range of broadcast television signals, and are not served by cable television. For them, satellite transmissions are the only link to television news, entertainment, and the mainstream of national events.

The letters which I receive from Maine satellite viewers express concern over the cable television industry's "scrambling" of satellite-transmitted cable programming.

No one challenges the right of the cable industry to retain ownership of their television programs. However, I share the concern of satellite dish owners that access to scrambled television signals should be available to all those who want it, and at a reasonable cost.

Like millions of satellite dish owners in other rural areas of the United States, Maine citizens express fears about not enough decoding devices being made readily available to meet demand. The prospect of different channels using different scrambling codes, requiring different decoders for different channles, is also of great concern.

S. 889 would go a long way toward meeting these concerns. It would require the Federal Communications Commission (FCC) to issue uniform standards for scrambling.

The Federal Trade Commission would be required to investigate programs pricing and distribution, and to make sure that the satellite television programming market is developing competitively.

The cable industry would need to allow for the sale of decoding devices by multiple non-cable distributors. Cable programmers would not be allowed to discriminate among different distributors offering similar distribution services.

The FCC also would need to begin rule-making to facilitate "to the maximum possible extent" the provision of broadcast network television to remote rural areas.

At the same time, S. 889 would provide for criminal penalties for persons who interfere with satellite transmissions.

Obviously, the legislation involves complex issues of law and technology. However, the letters which I receive from Maine citizens reflects a simple plea: for equal access and fairness in television viewing.

The law must protect equally the rights of broadcasting networks, cable programmers, and the viewing public. S. 889 would do so. It is balanced legislation. It would preserve the right of cable programmers to scramble signals and charge for viewing, while at the same time promoting fairness and equal access in the satellite programming market.

The law also must enhance the vital communications links which help bring us together as a Nation. The television programs which are available in Boston, New York, Chicago or Washington must be equally available in remote parts of Maine, Kentucky, Texas or North Dakota.

S. 889 would serve this purpose. It will balance legitimate interests, and bring us all closer together.

I congratulate the Subcommittee for holding this hearing. It is an important step toward enactment of legislation which is needed.

STATEMENT OF DORIS M. OLIVER[1]

Mr. Chairman and Gentlemen of this Committee, I wish to thank you for allowing the TVRO consumer to testify here today on behalf of the American people and TVRO consumer.

We come here with great respect for the members of this committee in this 100th Congress and ask for your respect in turn for all American Constituents and our right to protect our freedom as guaranteed by our Constitution, with particular reference to:

First amendment guaranteeing Freedom of speech, and Free Flow of information.

Fourth amendment guaranteeing security of our persons, houses, papers and effects against unreasonable search and seizures.

Fourteenth amendment, section 1, inpart quote "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." Unquote.

After reviewing the list of witnesses chosen to testify here regarding the Satellite issues, I must say I do feel intimidated, not by the people, but by the Mega bucks they represent. As a Consumer, testifying for the consumers, this shows exactly the problem we are confronting, not only here before the House and the Senate, but also in our Cities, Counties and State Governments.

These large Monopolies are reportedly spending millions of Dollars across the Nation to get legislation passed and paying for adverse publicity to help obtain legislation against the Satellite Dish Antenna thru Zoning, Safety, Aesthetics, Copyright and Franchise Protection.

Federal Communications Commission (F.C.C.) has failed their responsibility. They fail to act when notified of a pending Zoning problem(s) and will react only after the consumer has spent hundreds of dollars to only still have ordinances or zoning regulations in place by City, County and State and worded in violation of the F.C.C. rulings.

Why should the consumer have to spend moneys they don't have to protect themselves from these unfair ordinances and then have to pay $200 plus an hour for attorney's fees and lost time on the job, especially when the F.C.C. has clearly defined rules reguarding Satellite Dish Antennas (TVRO's) such as F.C.C. Docket 85-87.

Some Mayor's and County Commissioner's and Council people have openly stated F.C.C. does not tell them what to do in their City or County and then the F.C.C. runs and hides in a dark corner and allows this to happen. (See Attachment's 1 thru 5.)

We, at this time, request that the 100th Congress include in Senate Bill 889, and H.R. 1885 that the F.C.C. will, in fact, respond to such notification and prevent such harassment of citizens and also delete all references of the word Aesthetic from F.C.C. Docket 85-87, the reasons being that everyone has their own interpretation of this meaning. Home Owners do take pride in their homes and property. Let them continue to do so. There are no apparent restrictions on other types of antennas in regard to Aesthetics. We request uniformity for all antennas, which should include satellite dishes.

We, the consumer petitioned F.C.C. to establish an industry standardized decoder. (Reference Petition for Rulemaking, by F.M. America, General Docket No. 86-336), which was not accomplished. Upon reading F.C.C. response, Docket 87-62, I have found it, in my opinion, to be blaitently false and so will you, should you investigate. Again, the only apparent source of information used has been the Mega Bucks scources like G.I. and H.B.C. and others.

You have or will hear from members of Broadcasting and Communications Association of America (S.B.C.A.) thru North America One, their radio station, on satellite, who also "claim" to represent the consumer. Not so, as publicly stated. If you will verify the names and organization's listed as members and making this claim you will find they are heavily into the monopolies in one way or another.

Programmers are advertising the Videocipher II as the industry standard. This is not true, as evidenced by existing B-Max, Sony, Oak Orion, V.C. I, V.C. II and Starlock, Why do we have to purchase all of them to get programming? Blue Max, although not in use, this technology is still available and could be placed back into the marketplace any time.

General Instruments (G.I.) and Black Market Chips are the only ones making money right now.

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[1] The attachments referred to throughout this statement were not reproducible.

We know the Federal Trade Commission and Justice Department are investigating, and if they have not already, they might possibly find that G.I. and/or M/A Com leaked the information to this new technology to allow Black Market Chips to Flood the market place, to create a rapid sale of VC II's, thus giving a false impression the consumers are happy with this technology. We are not, actually, we are extremely disappointed. It's hard to think that the F.C.C. could allow this to happen. If the market place had been working, there would be no cause for the illegal chips to exist.

The consumer has had to pay $395.00 for the VC II and now has been asked to pay an even more absorbent price due to "supposedly" a shortage of VC II's. Should G.I. change this technology toward the end of the year as rumored, we will have to buy new decoders or an adapter reportedly call the "Side Kick" if that is, in fact, a Decoder, with little or no return of money on the obsolete VC II. These decoders do not work where there is terrestrial interference. They are also not compatible to all receivers which have been sold and they should be. If we buy one and find we can't use it we are out the money and end up with a 400.00 dollar plus paper weight, otherwise known as no refund, a consumer is bitten again.

Then General Instruments announced the newest idea of the Integrated Receiver/Decoders, (I.R.O.) This is fantastic in theory, but in reality it is a disaster. If the decoder does not work no one other that G.I. is authorized to provide service and then, your whole system is down, because it can't be dismantled and returned for repair. There will be no television until who knows when. The complete unit must be sent in. No Loaners are Supplied and no offer made.

As with the VC II Stand Alone, we have the cost of shipping and the cost of repair. Since G.I. alone is authorized to work on the VC II's, not only do we have to pay what they feel like charging but, we have no way of knowing what was actually wrong with our equipment, we can not trust M/A Com and/or G.I. based upon past history.

Gentlemen I have another concern which is a strong possibility. Let's say I were to own a VC II, and I have full authorization on it. After, lets say six months, my VC II goes off and quits working. Who is to say that General Instruments didn't come into my home Via Satellite signals, instructed it to blow out or burn out the chips, battery to quit working, what ever, then tell me after, I must buy a new VC II or I.R.D. unit.

You now see that there is a real problem in allowing any company to have this control over any electronic equipment in my home or yours.

You must see what is happening. Other manufacturers could apply this same technology, like with my car, causing me to buy a new car. I strongly believe that this is a direct threat and a violation of the 4th Admendment.

Gentlemen, there's a real problem coming. What happens if your computors are shut down because of a Mirco Wave signal sent from a satellite? Questions upon Questions are unanswered.

What would happen to Wall Street should this happen to their Stock Exchange equipment and/or systems?

Is it possible that the F.C.C. knows about this? If so, why are they allowing this to occur?

Additionally another concern with the VC II is that it was engineered for heat distribution. Now that the boards are being epoxied to prevent pirating, are they safe or will they start a fire in my home? I care about my home and family.

Next, if I need repairs on my 1973 Dodge, I have the Privilege of getting more than one opinion or estimate. This is not the case with any VC II or I.R.D's. Should damage to the VC II be by an act of God or Vandals, my home owners insurance requires 3 estimates for repair. This can not be done with VC II or I.R.D.'s because G.I. will not allow someone else to compete or be allowed to make repairs.

Since I paid for insurance coverage in the event of this happening why should I have to pay again, because I can't get these estimates. This is a fine example of no Consumer Rights. I would call this a rip off, wouldn't you?

Now we have the great American Major Networks, ABC, NBC, and especially CBS who feel that 4.7% of our nation does not count for television reception. The figure of 4.7% is quite low, in their opinion.

In rural America areas such as where I live, we can not receive local affiliates network programs. The only access we have is direct from the Networks.

Public broadcasting: Reception, aren't they supposed to fill the void where Networks failed? Reportedly PBS wants to Scramble in order to have stereo. Who are they trying to fool?

Stereo can be accomplished cheaper and better without the VC II for example, discrete stereo is much more pleasant and cheaper than the VC II decoders. PBS

must think that American citizens are uninformed. Wake up now, and stop wasting my taxpayer's dollar. Those dollars are needed other places more important.

Since we have had our TVRO, we have become better citizens by keeping abreast of National and World events. We can even pickup Radio Broadcasts Via our Dish. This technology fills a void. We are able to watch you gentlemen on C-SPAN. I have been informed there are cable companies that do not carry either one of the broadcasts. In addition you might say we can also keep Congress apprised of our vote on varing issues, such as the Fairness Doctrine, Budget, Lie Detector issue and Senate Bill #2, "Amendment to the Federal Election Campaign Act of 1971."

Gentlemen, the Satellite Dish is very important to this country's voters. We don't want to be brain washed by large corporations or the cable companies, etc., who think they are in control and know better then its citizens, your voters.

Any and all programmer's who use Commercials should not be allowed to scramble to the home dish owner's, or any one else. Any prudent Company official who is interested in selling should be interested in the rural market place, just as the ones in the city.

If a programmer scrambles, the company who has placed the commercial with that programmer should withdraw all financial support and place it where it will do some good. The sale of nuts and bolts, help keep the unemployment rolls down and us strong as a nation. In addition the sale of Dishes also keeps the employment rolls high. We are supposed to be leaders in technology and not followers. I have no idea as to how many dealers, distributors and manufacturer's are now out of business. This is our Marketplace last year and now. Our Bankruptcy courts could provide you the Statistics on the numbers which I can not provide you.

Now for the BIG question, Why is General Instruments building and Manufacturing the VC II's in Mexico? We need jobs, here. Is this move in the best interest of this country?

At this time I make two formal challanges to you.

1. Each of you return to your home state and visit the homes of Dish owners. Ask them any question pertaining to these issues. Observe for yourself the reception of Network's over the air broadcasts, Cable and Satellite Dish. These homes should be picked at random and in various areas. When you return here to Washington, D.C., please send me a written evaluation of your personnal finding's.

2. That you the members of the 100th Congress correct this problem by immediate legislation, today. The 99th Congress failed to act, now you must react. This is currently a greater problem than many in this country realize.

In conclusion I would like to leave this thought with you.

Our Constitution is more important than the dollar bill, without it, we won't have a need for that dollar bill.

STATEMENT OF JAMES M. THEROUX, CHIEF EXECUTIVE OFFICER, METROPOLITAN CABLEVISION, INC.

Mr. Chairman, members of the subcommittee, my name is James M. Theroux. I am the President and Chief Executive Officer of Metropolitan Cablevision, Inc. a wireless cable system that first offered a multiple channel package to subscribers in Cleveland in 1986 and now operates with 10,000 subscribers in the city's metropolitan area. Other wireless cable systems are offering or are about to offer service in Washington, D.C., New York, Detroit, Milwaukee, Philadelphia, San Francisco, and other cities. Officials from a West Coast city have contacted me seeking advice on setting up a wireless cable system to break the wired cable monopoly in their community.

Wireless cable uses a collection of microwave frequencies [1] to deliver up to 32 channels of satellite programming, in addition to local television signals. Signals from satellites are received at a central location from which they are transmitted on a point to multi-point basis directly to small, inexpensive receivers. These receivers tune in not only our signals, but all available broadcast signals as well. Thus, with wireless cable, there are no must-carry issues; there is no cable bottleneck.

As an established wireless cable system, Metropolitan's rate of subscription has accelerated dramatically and we expect to have 30,000 subscribers in 1988. Our subscribers pay less for installation and monthly service than do cable subscribers in

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[1] Wireless cable uses frequencies assigned to the Multichannel Multipoint Distribution Service ("MMDS"), Instructional Fixed Television Service ("IFTS") and the Operational Fixed Service ("OFS"). In some instances, channel capacity is leased; in others, the operator is an FCC licensee.

the Cleveland suburbs. Wireless cable is a solid, reliable alternative to wired cable and represents a practical competitor—if wireless cable can obtain programming.

The subcommittee has before it today S. 889, a bill designed to ensure competition in the delivery of satellite programming. I favor the enactment of S. 889. However, it does not go far enough. It assures only that programming will be available to back-yard dish owners, but it says nothing about availability to wireless cable, wired cable's most direct competitor. To choose a back yard dish over cable, a consumer must purchase receiving equipment (including a decoder) and then deal with programmers. To choose wireless cable, a consumer simply dials our phone number instead of the local cable company's number.

Of course, a consumer will be discouraged from calling us if we cannot offer programming similar to that offered by cable. Without legislation, I am fearful that wireless cable will face the same fate as would-be third-party program packagers: The cable dominated programming industry will simply refuse to negotiate with us—or will deal with us only on a discriminatory basis. For example, Metropolitan Cablevision has Showtime only because we filed an antitrust lawsuit to obtain it. Our experience to date is similar to other wireless cable operators.

Wireless cable is technologically as good as cable. Because wireless cable uses fewer noise-generating ampliphiers than wired cable, a wireless cable picture is sometimes better—and always as good as—a cable picture. Furthermore, wireless cable is secure from piracy by unauthorized viewers. The encryption system used is fully addressable, that is, each decoder can be authorized and deauthorized remotely, channel by channel. It is more secure than the most secure cable system. Wireless cable offers excellent quality and is safeguarded against unauthorized use.

Cable sees us as a competitive threat, even more potent than back yard dishes. Cable is concerned that the entrance of wireless cable into the marketplace will bring an end to the price domination cable exercises in the sale of satellite programming. It is imperative to break the cable monopoly and to provide fair and accessible programming to consumers. If S. 889 were amended to ensure that programming be available to wireless cable in addition to back yard dish owners, we could create the price competition that is the hallmark of a free marketplace.

In conclusion let me reiterate my support for S. 889 and my urgent request that the subcommittee take this important legislation one step further to ensure that wireless cable gain access to programming. We are an essential competitive alternative to wired cable. Competition in the marketplace will protect the interests of all American consumers.

Statement of the National Telephone Cooperative Association

INTRODUCTION

The National Telephone Cooperative Association (NTCA) is a national trade association which represents more than 450 small, independent cooperative and commercial telephone companies throughout rural America. NTCA members serve millions of subscribers in some of the most high-cost, sparsely populated areas of the nation. Their mission is to ensure that rural Americans receive telecommunications services equivalent to those available to urban residents.

We would like to share our concerns about the effects of satellite signal scrambling on earth station owners in rural America and request that a copy of this statement be included as a part of the record in the July 1, 1987 hearing entitled "Hearing on S. 889, Satellite Television Fair Marketing Act of 1987."

BACKGROUND

Satellite earth station technology has ushered in a new era in the reception of direct-to-home video communications. In distinct contrast to radio, television, telephone and cable, the benefits of satellite were first realized in the most rural parts of the country where people are denied access to both broadcast and cable television because of the remoteness of their residences. With the advent of satellite, dish owners living on farms and ranches and in small towns were afforded comparable access to information and entertainment to that afforded city dwellers.

However, rural America's access to a wide variety of satellite programming has been diminished by the decision of a number of programmers to scramble their programs and by the way some of them have chosen to distribute their programming. A further hindrance to access is the lack of decoders on the market.

ISSUE

NTCA recognizes the fact that programmers are entitled to scramble in order to protect their signals. However, we believe they have a responsibility to make their scrambled programming readily available to earth station owners regardless of their geographic location. Dish owners in rural areas outside of cable franchise areas are still not receiving a wide variety of programming available to city people. Cable companies, the primary distributors for programmers, do not provide service to most of rural America. Third party distributors have not been allowed to provide the most popular programs. In addition, decoders are still widely available. Thus, we conclude that the marketplace is still not working and that legislation, such as H.R. 1885, "The Satellite Television Fair Marketing Act" would be a step forward in achieving a fair and equitable market place, easily accessible to rural Americans.

PROGRAM DISTRIBUTION

When the major programmers began scrambling, they decided to market their programming to earth station owners either directly or through cable companies.

In June, 1986 we expressed our concern to this subcommittee about these distribution methods on the basis of the potential for anticompetitive activity on the part of the cable companies and unreasonably high pricing for programming sold directly to the earth station owner by the programmers. We stated our opposition to exclusive distribution plans or any other marketing scheme which would limit the rural dish owners' access to programming.

To that end, we support the entry of independent distributors into the marketplace.

Eighteen months after the programmers began scrambling it is clear that the marketplace is hostile to cable-independent competitors and that much of rural America still is not being served.

To date, no independent distributor has been able to develop a complete package of programming. Some potential distributors, such as Amway Corporation and Home Satellite Service failed to reach an agreement with programmers. The National Rural Telecommunications Cooperative (NRTC) has had only modest success, for its package is a very limited one, offering nine basic channels, no regular premium services, and a pay-per-view movie service.

Today the rural dish owner does not have competitive programming sources to choose from. He must either deal directly with a programmer, calling a different 800 number for each service, or his local cable operator if he is fortunate enough to live in or near a cable franchise area. The problem is that most rural dish owners do not live near cable areas so they are effectively limited to dealing with only one source, the programmer.

Without independent distributors, real competition in the delivery of satellite programming to earth station owners will never exist.

DECODER AVAILABILITY AND INTEGRITY

Since the introduction of scrambling last year, there have been continuous questions about the availability of decoders, especially in the more rural parts of the country. Until recently General Instruments (GI) and the Federal Communications Commission (FCC) denied there was a shortage. Now they admit there is a shortage and GI promises to make necessary corrections by the fall of 1987.

A number of rural telephone systems sell or would like to sell satellite equipment. The shortage of decoders prevents our telcos from keeping up with subscriber demands, thus further reducing dish owners' access to scrambled programming.

One reason for the shortage is the demand for decoders by those who have obtained black market chips illegally. The chip is installed in the Video Cipher II and allows the "pirate" to receive satellite signals without having to pay individual programmers for those signals. NTCA members who sell satellite equipment are concerned about the breach of the decoder's security system and its impact on sales and distribution. They should not have to compete with illegal decoding equipment distributors. After all, they have made a substantial investment in the Video Cipher II and there must be further assurance that the system will be protected from piracy.

The problems of decoder availability and security discourage other telcos who are not currently doing so, from becoming involved in the satellite business. The availability and integrity of the Video Cipher II will quicken the interest of these potential suppliers and hasten the access of programming by dish owners residing in remote areas of the country.

LEGISLATION

NTCA is very concerned about rural dish owners' access to reasonably priced programming and the unavailability of decoders. Therefore, we support S. 889 "The Satellite Television Fair Marketing Act," introduced by Senator Gore, since it provides that all scrambled programming must be made available to dish owners, encourages the use of independent program distributors, provides for federal oversignt of the development and standardization of scrambling technology, and penalizes piracy.

CONCLUSION

Programmers are entitled to scramble to protect their signals. However, they have a responsibility to make their programming accessible to earth station owners at reasonable rates in a competitive marketplace. In addition, decoders should be widely available and their integrity protected. In today's market this is not the case. NTCA supports S. 889 because it would promote a more competitive marketplace and improve telecommunications service in rural America.

STATEMENT OF RONALD LIGHTSTONE ON BEHALF OF VIACOM INTERNATIONAL INC.

Mr. Chairman and Members of the Subcommittee: I have a very brief opening statement to present to you today.

On behalf of the Viacom International Inc., I am pleased to testify before you again on the delivery of scrambled satellite television programming to home dish owners. We welcome the opportunity for all involved to learn first-hand of the recent positive developments and trends in this new market.

Viacom owns and operates two of the nation's largest satellite pay television services, Showtime and The Movie Channel, and the advertiser-supported services, MTV: Music Television (MTV), Video Hits One (VH/1) and Nickelodeon. Viacom also owns Viewer's Choice, a satellite-delivered pay-per-view service, as well as a one-third interest in the advertiser-supported service, Lifetime.

These programming services are viewed via cable in millions of homes across the country. Showtime, The Movie Channel, MTV, VH/1 and Nickelodeon are also distributed through other technologies, such as satellite master antenna technology (or SMATV) to apartment complexes and other multiple dwelling units through SMATV operators and to the lodging industry through hotel/motel distributors. MTV, VH/1 and Nickelodeon are also distributed via multi-channel multipoint distribution technology (or MMDS). And today, because of the marketing policies we have implemented, all of Viacom's services are available to the more than 1.5 million dish owners nationwide.

Three years ago, the Congress anticipated the emergence of the home dish market, and crafted legislation that both protected the property rights and integrity of the creative product we distribute and created incentives for programmers to serve home dish owners. The Congress was ahead of the technological curve, and it established a fair and workable mechanism that meets the needs of viewers and programmers alike.

We at Viacom have endeavored to follow your mandate—in both the spirit and the letter of the law. And we believe that what has developed today is a competitive market distinguished by a plethora of reasonably-priced program services for home dish owners.

To highlight where we are today:

Showtime and The Movie Channel have now been fully scrambled since May of 1986. Due to the scrambling of these services, we have made major inroads against theft of our satellite signals by hotel-motel and other commercial establishments. Scrambling has also enabled us to make our services widely available to home dish owners. As of today, we have sold roughly 120,000 subscriptions to Showtime and The Movie Channel. Increased sales rates of our services and our competitors' services indicate strong consumer acceptance and renewed confidence in the market.

Most important to the issues being discussed today are the positive developments that have taken place in the pricing, packaging, and marketing of satellite-delivered television services. Since I last appeared before your Committee in March of 1986, monthly and annual prices for our and that of our competitors have steadily moved downward in a series of price reductions spurred on by competition. Our prices have dropped as low as an effective monthly rate of $10 for either Showtime or The Movie Channel and $15.50 for both. Prices to dish owners for our pay and pay-per-

view services are comparable to or lower than the rates typically paid by cable subscribers.

Even though most basic services have not yet scrambled, packages of program services are now being put together by multiple and competing sources, both within and without the cable industry. Viacom has worked hard to become a leading one-stop package of third party services. We are currently making available for a monthly price of $10.95 and an annual price of $120 a package of 12 satellite-delivered basic services. Negotiations with additional programmers are underway. Here, too, prices reflect the competitive nature of the marketplace. Subscribers to Viacom's program package can receive the twelve basic and our two pay services for as little as an effective rate of $20 per month—comparable to if not less than the rates typically paid by cable subscribers.

We have also worked together with satellite dish retailers to stimulate sales of our program services and their equipment to dish owners. We have created incentive and marketing programs for dish retailers, including program enabling them to package their hardware with our software for the convenience of the consumer. We have also instituted cash discount programs which retailers can pass on to consumers, resulting in effective monthly rates of $11.75 for both our pay services and $16.25 for these two services, plus our twelve-service package. These marketing programs are direclty competitive with similar programs that our competitors have instituted. In addition, we have also formed a TVRO Advisory Board comprised of equipment distributors and retailers, so that we can hear and address their concerns on an ongoing basis. We also publish and distribute a monthly newsletter to roughly 10,000 satellite retailers nationwide, providing updated TVRO-related information. We believe that these efforts have gone a long way towards eliminating the apparent tensions between program suppliers and dish dealers that surrounded the introduction of scrambling over a year ago.

We have also taken steps to address the issue of decoder prices. In cooperation with a leading equipment supplier, we have made VideoCiher decoders available for purchase in conjunction with our programming at an effective rate of $313 per decoder unit, of $82 off the usual list price. Similar offers ae available through others.

We believe that the actions we have taken to serve the HTVRO market have directly contributed to the resurgence of satellite dish sales.

We also respectfully believe that the actions we and others have taken in this market obviate the need for the type of government intervention contemplated by the legislation introduced this year (S. 889). Although we at Viacom understand—and wish to be fully responsive to—the concerns raised by that proposed legislation and the intense constituent interest in these matters, we believe that the market is developing in a manner that faavorably resolves these issues.

The heart of S. 889 is a provision which would effectively mandate that satellite programmers, such as Viacom, make their programming available to third party distributors for sale to dish owners. We feel that the public policy balance involved in between access to programming in a competitive market and protection of the legitimate proprietary rights of programmers and distributors. In our view, this legislation fails to strike the proper balance.

Viacom—like any other business—wants to maintain a good, solid reputation in the marketplace. Indeed, as a service company, our commercial success is directly related to our ability to deliver a service quickly, inexpensively, and responsively.

Under the legislation pending before the Committee, our ability to control our representation in the marketplace would be severely curtailed. We would not be able to select distributors (who are, in effect, our retailers) to enhance our position in the marketplace. Rather, we would be forced to deal with everyone who met established criteria.

This has the potential for everely damaging our reputation. If an operator is not attuned to delivering our service in a timely fashion, or if he is unresponsive to consumer requests, or if billing is mishandled, we are the ones who suffer.

Moreover, part of our success in the marketplace is due to our ability to perceive—and react to—customer needs. Interposing an unlimited number of intermediaries between us and our customers would interfere with or ability to perceive and respond to customer needs and requests.

The existing market, without government intervention, has already produced third party packagers, as well the benefits (e.g., price competition) that flow from multiple sources of product. In addition to our distribution of third party services, other distributors are also furnishing program services, and will soon be a significant force in the market, competing with us and each other. For example, Consumer Satellite Services and Satellite Video Services (two large equipment distributors), Amway Corp., Satellite Source and the National Rural Telecommunications Cooper-

ative—all of which are independent of cable—are putting together packages of basic and premium programming to be offered to dish owners. Thus, the legitimate issues raised at this and prior Congressional hearings (lower prices, the need for a single encryption standard and the availability of program packages) have been addressed by the marketplace which, on its own, is solving any problem that this proposed legislation seeks to address. We accordingly do not believe that a legislative solution is warranted at this time.

While continued oversight of these issues is important, we believe that the industry has met the tests of competition and fair service to consumers, as demonstrated by the FCC's recent comprehensive review of and conclusions regarding these issues.

Mr. Chairman, on May 8, I shared Viacom's views on S. 889 in a letter to all Members of this Committee. This letter is attached to my statement today.

I would be pleased to respond to your questions.

Thank you.

STATEMENT OF R.D. OCHS, DIRECTOR, THE ANTENNA WORKS, INDUSTRIAL AND RF ENGINEERING CONSULTANTS

Good afternoon Mr. Chairman, I and the many dealers throughout the nation for whom I speak, thank you for organizing these hearings. I know that I not only speak for the dealers who have had direct input into my testimony, but also for the many dealers who are not yet fully aware of the impact which the National Rural Telecommunications Cooperative's (NRTC's) will have on their business.

There is no question that the NRTC's will benefit from this new emerging technology. Their ability to stream line many of their operations will be enhanced as they replace current ground links serving regional operations with what are now links capable of hopping entire nations and continents.

There is also no question that in most of the communities which the NRTC's serve, that their marketing areas are the least desirable, allowing for the fact that private and public power had taken most of the lucrative routes, leaving the Rural Electrification Administration (REA) and the Coop's to serve the hinter-lands. This is not to suggest that in today's world the NRTC's only serve the jack rabbit gulch's, they in fact now also serve the suburban attachments to many major cities.

UTILITY REGULATION

The NRTC's as utility companies, are in some states precluded by state statutes from participation in nonutility business and in some states specifically from Cable television activities. But home satellite television or Television Receive Only (TVRO) is not cable and in some states, NRTC members have in fact established TVRO operations. Unfortunately, where these operations exist, competition in the market place is severely inhibited, and a false market established. As we will discuss later in this presentation, Congress is going to have to decide, between trade offs of free and open markets or subsidizations to selected market segments; at the expense of free enterprise.

STATUS OF TVRO AND CABLE MARKETS

In several states and before Congress, legislators are being told that much of the TVRO market place is underserved. And today that is in all likelihood true. Ninety (90%) of the independent dealers are out of business, and I would suggest that no matter what happens, many will not return to this industry. New independent dealers will emerge.

I would have liked to have discussed many other facets of the broadcast, cable and satellite industry issues, and how the independent dealer has stood as the buying public's only guardian against the shoddy manufacturers, dishonest publications and the interbreed cable programmer/Multi-system operators (MSO) whose monopoly or duopoly tactics have been designed, since 1982, with one purpose in mind; to give the cable-programmer cartel total control, not only over the programs carried on cable systems, but over the actual creative content of those programs.

Today, the average Cable franchisee is not offering to build the large heavily tiered system envisioned only a few years ago, but in fact is looking at how to consolidate, into what is referred to as "the best of cable". This would translate as America's 5th network. If cable is allowed to merge or gain cross-ownership with broadcast, it would mean the end of many first amendment protections.

In fact several other bill's which are or will be before the Congress this session have as their intent the elimination of competition within the cable industry. Each

of the new pieces of legislation would in effect eliminate one more small voice, and further inhibit the free flow of information.

The TVRO industry was originally conceived by the FCC as a limited Direct Broadcast System (DBS) with a capacity of twenty to thirty channels. It is to the credit of the independent dealers who with their own private capital, developed this industry, and who envisioned a programming system with the "diversity of a magazine rack in a major supermarket". It should be noted that hearings in 1982 established the fact that the independent dealers always envisioned the payment of programmers and uplift facilities.

In the satellite industry, the hard working independent entrepreneur was and is the only hope that the customer has for a fair deal. When the manufacturer will not warranty the part, the independent dealer dips into his pocket; when the manufacturer disappears, the independent dealer is there; when the product turns shoddy, the independent dealer unlike the chain store, refuses to push it into the market . . . . and the independent dealer has done this without the need for governmental enforcement or subsidies at any level.

The home satellite industry represents a true cottage industry, which created new jobs in communities and brought new revenues to treasuries. It was and is a created market, not a transfer market.

THE CASE AGAINST UTILITIES

That is what makes my appearance here today even more ironic, because what I came to speak about is so insidious that only the most alert will see the long-term problems, so invasive that like the disease that it is, its malignant dispersion thru social acceptance can only be arrested by radical surgery. Hopefully here in Congress, but if not then by Courts.

If neither the Congress or the Courts hear these warnings, then American business as we know it is doomed. The cancer of governmental, utility (which is really the governmental control of private capital) and the "non-profit" organizations entrance into and eventually replacement of true private enterprise in the end. We will have what I choose to call Megla-Corp.; a multi-national, multi-industry entity whose ultimate base is in government contracts or in industries controlled by government.

The problem is the use of government or government regulated funds and programs in direct or indirect competition with free enterprise. The issue in satellite is predominantly the latter, but either of these practices are an endangerment to our society.

THE SOCIAL BASES FOR PROTECTION

The American Constitution, much like the Swiss Constitution after which it was modeled, is a social contract between the American people; designed to form an association thru governmental laws in support of our common interests; when we must act in common to survive or move forward.

The government was never meant to do for the people what they could do for themselves.

Please consider what we the people had already done for ourselves. We had down scaled the cost of the technology by an average of 10% per year. We had placed about 20,000 independent dealers in the market place; that was one dealer for every 436 square miles. You should note that these dealers served the rural market over the urban market by a ratio of 7 rural to 3 urban.

We had in place a distributor support system of over 500 distributors nation wide. They were supported by nearly 1000 manufacturers domestically, and the industry was growing by 40% per year. In 1984 we had bright prospects for achieving a 2 million unit per year sales level before 1990. We were well on our way to what I believe to be a 64 million unit first round market.

CABLE COURTS NRTC'S

Then the ax fell. In 1985 the programmer/MSO cartel's deliberately introduced the scrambling technology in such a manner so as to destroy the independent dealer. There could have been no other intent. The TVRO industry had always known that encryption would come and was prepared to work with it. What the cartel's did was to arrange product supply in such a way as to place the independent dealer in what appeared as a position of incompetence.

When the National Cable Television Association (NCTA) and the Community Antenna Television Association (CATA) walked out of these hearings last year, they

needed a solution to a problem. How could they convince Congress that open marketing existed without creating competition for the cable industry? Magically, they found just the right partner. Since many states already forbid utility activity in the cable industry; if they could cut a deal with the NRTC's, which mostly exist in areas not served by cable, they would have the noncompetition that they desired and would not have to worry about the larger private and public utilities becoming involved. Congress would believe an open market existed and cable would have created a new friendly partner.

Unfortunately at this point the plot thickens. After one year the NRTC's still do not have a programming package in place; this because of the double dealing by the same cable/programmer cartels; and the NRTC's have been left to founder in cables wake.

NRTC'S NOT TRUE 3RD PARTY MARKETING

But that is only part of the story. While the cable/cartel has been double dealing the NRTC: It needs to be pointed out that even if the NRTC did have a package available, they still would not be a true third party marketer.

To be a true third party marketer they must be able to act like a real competitor:

A. They must be able to buy programming at the individual program level and build their own packages.

B. They must be able to move within the market and sell their packages where ever they want, including cable areas.

C. They must treat their Association members and any other retailers they acquire by the same standards.

But unfortunately I do not believe that the NRTC's will ever develop in to real third party marketing. The cable/cartel's simply will not allow that to happen.

The real threat to the independent dealer is in the nature of the utility industry itself.

UTILITIES ARE NOT FREE ENTERPRISE

Earlier in my working career, I provided management consulting services to segments of the utility industry. At that time I was involved in some of the largest industry mergers. I could spend the next several hours, discussing the pitfalls of utility accounting as we practice it in this country. I have seen Utilities move materials between operating divisions and with each succeeding step add 15 to 20 percent to the cost of the item. I have been donations to charity slid into PUC rate base accounts so that earnings could be enhanced. The majority of the public simply does not understand that a utility is the only organization that can get bigger by simply spending more.

A utility simply does not represent a free market force. By definition it is not free enterprise, and in the case of the cooperatives, the Federal loan guarantees simply give the NRTC's market power not available to any other domestic corporation.

Previous, Federally funded studies designed to examine the impact of utility competition of free enterprise and specifically on small business, identify many areas of concern.

Cross subsidies between regulated activities and the non-regulated activities within a given utility are almost impossible to detect, let alone control. This renders any new activity in which a utility becomes involved, as being a subsidized activity by the regulated rate base.

In the case of the NRTC's the Federal 3% loan guarantees make the problem even toughter, in that they can compete with money rates that are not even available to the independent dealers' own banker.

Utilities can finance regulated ventures with ratepayer funds by either charging the effort as a current expense or by adding the capital equipment to the rate base upon which rates are figured. Even where a separate subsidiary is employed, it will enjoy the parent firm's credit rating as it seeks financing. The opportunity to file consolidated tax returns offers unique advantages to the utility venture.

Additional problems in the area of national access between utilities of consumer preferential information, shared cost of equipment, cross labor expense, and shared overhead all have their own specific impacts.

GOOD HISTORICAL STUDIES

I would call attention to several studies done by the Office of Advocacy, Small Business Administration. While these studies do not specifically discuss the TRVO

industry, the problems they illicit are identical to what this industry will face, if the Utility industry is allowed to participate.

The two papers which I would like to have made a part of the record are: 1. Utility Competition with Small Businesses: recommendations for States on Utility Energy-Related Programs and the Commercial and Apartment Conservation Service Program (March 1984) and 2. Utility Competition with Small Business, Final Report, by Stronberg and D'Addario, LTD., prepared for the Office of Advocacy, SBA, June, 1986.

Of further interest is the testimony given by the National Federation of Independent Business (NFIB) before the House Ways and Means Committee Subcommittee on Oversight, June fifth of this year. I would ask the statement of John J. Motley III, Director of Federal Government Affairs also be included as a part of my testimony. It specifically addresses the impact of Non-profit competition and the unrelated business income tax provisions of the Internal Revenue Code.

SUMMARY

The market has been served well by the independent businessman/dealer; competition was keen, supply was good and the consumer was well serviced. Twenty four months after the monopoly play, by the programmer/cable cartel, and the total lack of administrative enforcement by the current Administration of even the basic statues involving monopolies and cartels; has left the market in disarray. Even if public confidence could be returned to June 1984 levels today, it may take three or more years to return this industry to its previous state of health.

Either you must rule the NRTC's out of this market, or you should move to allow all utilities in.

Removal of the NRTC's along with the other provisions of S. 889 will allow competition of the independent market to reestablish itself.

If you do not believe that the independent dealer can come back, than you must assure competition by opening this market to all utilities.

If in fact you do not move in either of the above directions, than you, the Congress of this country, will have moved both against the independent businessmen and against the citizens of this country. Against the independent businessmen in that you are sending a message to all business men, that no business is ever again going to be safe from attack by Federal or State created entities.

By further delay in acting on the entire question of broadcast, cable and satellite regulation, you will have defaulted into denying the citizenry, the protection it needs for its first amendment rights. Your vote of several months ago to remove cable from the fairness doctrine will not only work to strengthen cable; it will further allow cable to delay the development of this new technology; and ultimately to slow the free flow of information. In the end you will have moved against the first amendment. . . .

STATEMENT OF TOM WENRICH

My name is Tom Wenrich. I reside in the state of California. I am deeply honored to have the opportunity to address this esteemed assembly.

But, as honored as I am to be here, it is a shame my presence has been made necessary. The very fact I am here to represent the real victims in this issue, the consumers, should illustrate that something is very wrong. If consumers had a fair and competitive marketplace, my presence would not be necessary.

Gentlemen, this is very much a consumer issue. Consumers are not here to ask you for the world. We are simply asking you to pass a bill that is long overdue . . . a bill that restores fairness to the American consumer.

Americans believe part of what makes America great is fairness and justice. We hope justice and fairness are part of every decision you honored men make. Right now, consumers are clearly faced with a marketplace which is neither just, nor fair.

I ask you, where is the fairness in having to pay for programming we consumers have already paid for? Where is the fairness in being forced to pay prices for programming which are far higher than what cable companies pay for the very same signal, yet we do less with that signal, and unlike cable companies, receive no money for its use? Can you tell the American taxpayer why, when we can't find enough tax money to cure hunger, stop crime, or cure disease in this country, PBS can find enough tax money to scramble PBS television programs? Why is it so hard to fund V.A. hospitals, but it appears there will be funding to scramble AFRTS television programs?

Will you explain to cable subscribers, some of whom will see these proceedings while their rates keep climbing, why this Senate Bill 889, which could help slow their rate hikes, it still being debated?

Why must dishowners purchase a descrambler which is priced unrealistically high? . . . a descrambler which won't work with all equipment, which won't work in all geographic areas, which won't decode all services in the first place, and that once paid for and within a consumer's own property, can be rendered useless by the company that manufactured it? (A descrambler that may seem to be a majority standard one day, and become obsolete another!) Why must dishowners buy multiple descramblers to simultaneously view as few as 2 separate premium channels? This descrambler, the General Instrument Videocipher II, isn't even readily available to those who may still want to purchase one, even with it's numerous faults, because of a shortage of product, (and not, it seems, due to consumer demand). . . . One company, with a monopoly over the manufacture and distribution, leaving consumers with a take it or leave it marketplace.

Why are dishowners forced to buy programming from sources tied into cable companies, when cable companies declined to wire many of our homes (including mine), and when a 3rd party, independent of cable, would like to provide me programming at a truly fair price . . . but can't?

What about the "American Dream"? Many dish dealers put their hearts and souls into the hope the American free enterprise system, based on a fair and competitive marketplace, would let them too, compete for our business. Many good Americans have been knocked out of business by the so called "working marketplace" the F.C.C. says exists. Each dealer loss hurts us consumers as our access to answers and equipment is further reduced. Where is the competitive marketplace for consumers to choose from, when attempts at competition fall victim to monopoly situations? Is that a fair and level markeplace?

Ggentlemen, this is why I and millions of other American consumers ask you why . . . why . . . why is this allowed to happen to us?

We've done what you told us to do. We've written cards and letters. We've made phone calls, sent telegrams and sent mailgrams. Now we've sent ourselves, because it's the only hope left to us. We need passage of Senate Bill 889, and we need is now. (In fact, had a similar bill been passed when we originally asked for it last year, I wouldn't need to be here.)

We consumers are desperately hoping you will take action to show you *do* stand for fairness and justice . . . for the American consumer. Not just big business. We're not anti-business, nor are we anti-cable. We just feel big business has forgotten how to treat the very ones who made it big . . . us consumers. We're just asking you to remind them . . . and to give us a fair shake. Every consumer, including dishowners, cable subscribers, and taxpayers (some of whom may not even own a television set) . . . all will benefit from this bill.

Senate Bill 889 is a fair bill . . . a just bill. It's time has come. Please restore the faith of some good people you know . . . the American consumers. Pass this bill, Senate Bill 889, and never let this happen to the American consumer again.

STATEMENT OF K-SAT BROADCASTING, INC.

Over one year ago the U.S. Congress was alerted to look into the area of Satellite TV. Many forms of legislation were proposed at that time to bring about fairness and resolve difficulties in the Satellite TV and Cable Marketplace. Testimony last year abounded with proposals for intervention should it be discovered that after a few months the marketplace was still suffering. Collusion between the cable programmers and their cable divisions in the form of kickbacks were brought to a halt in hopes that the falsely inflated program prices would come down. The FCC assured the satellite dish owner that a low cost ($150) decorder would be forthcoming. The NTIA alerted Congress that in three or four months, program packages would develop, removing the need for legislation about distribution. MA/COM-G.I. satisfied Congress that the decoder technology could not be compromised and availability would not be a problem. Cable programmers assured Congress that legislation was not required for access by dish owners. We were reassured by the promise of a thorough investigation by the Justice Department, that an end to suppression of dish sales by smear tactics of the Cable Industry, and that sales would rebound in an unconfused marketplace for the Home Dish Industry. The Networks told us their plans to reach all Americans with translators and access would be assured. All this gave hope: translators, guaranteed access, unconfused market, low cost stand alone decoder, increased sales, price parity, program packaging, decoder availability uni-

form without compromise, no more dirty tricks and a Justice Department investigation. We of the satellite industry have waited and relied on these predictions, as did Congress.

One year later:

The Justice Department has not seen fit to maintain it's investigation. The programmers and cable companies have taken over the only Home Dish Trade Association of note (SPACE) and have used it to establish propaganda channels on satellite and confuse the Home Dish Industry.

Cable programmers have established new channels (Festival) with no access to home dish owners from the very start.

Sales of home dish units have fallen to an all-time low. Thousands of dealers have left the industry broke and betrayed. Small manufacturers have closed (Arunta). Large manufacturers (Birdview) have sought protection under Federal Bankruptcy laws. International manufacturers (Luxor) have declared The American Home Dish market as confused and devastated.

Incompatability with decoding equipment has rendered thousands of home dish owner's equipment useless.

The only program package of note (TBS) had no pay-per-view, no movie channels, and advertised many clear channels to give the facade of quantity. This fell apart in shambles.

The only channel (SBN) that guaranteed home dish owners access to the networks was immediately sued and it's well being is threatened.

There are no uniform methods of encryption and the industry finds six (6) decoders in use (Oak, Telease, B-Mac, VCII, VCI, and Sony).

PBS has begun distorting it's Westar 4-23 transmission of TV programming using the VCII and has attempted to remove access from the home dish industry of it's program listing.

The G.I. decoder has been compromised resulting in unfair activities against the dealer and consumer. G.I's failure to acknowledge this has lead to wide spead shortages and windfall profits by G.I. and the pirates.

The decoder now costs more than it did last year—that is if it can be found. The IRD unit (single source by G.I.) has placed a stranglehold on manufacturers and given G.I. an unfair advantage penetrating the satellite receiver marketplace.

The consumer is still over charged for service when you consider investment and responsibility of the dish owner.

Yet some will say the marketplace is working. It is! For G.I., the pirates, programmers and cable. What happened, as Mr. Dingel said in a recent hearing, to "That Public Park in the Sky"? What happened to "Freely Flowing information thru the public airways will access for all"?

We are not asking for money, regulation or protection. We are asking that the rules for a level marketplace be clear:

Non-discrimination of third party programming.

Uniform decoder standards.

Access not be denied.

Assured Free Flow of Taxpayer Supported Channels.

The changes in the Congress since this issue was last visited leaves the public with questions! The public needs to know: Was this change in the Congress one of:

Decision
Leadership
Fairness
Justice

The public wants to know—your actions will be your answer. Hasn't the public waited long enough?

STATEMENT OF ROBIN ADAIR 1/

On July 31, 1987 hearings took place on S. 889 and the telicommunications industry. Written testimory was submitted in addition to verbal statements. When I attended the hearing I listened carefully to each person and a second time when they were telecast on C-SPAN.

My testimony is based on fourteen years experience in electronics, including three years work in the HSD industry, and on documentation I have. I submitted written testimony for hearings last year, I submitted formal comments in response to the FCC's Notice of Inquiry 86-336, enclosed is my rebuttal to the Commission's Report to Congress and a copy of my testimony (submitted to the House Telecommunications Subcommittee) APPENDIX #1 & 2, and a twenty minute video tape. It is a montage of issues facing the telecommunications industry. At least eight other citizens contributed material/labor so picture quality is poor, but it is thought provoking. Several of the source video tapes follow the 20 min. presentation for reference/further information.

Many Representatives and Senators feel that the Report represents the current administration's perspective not a factual analysis. I ask that Congresspersons who feel the Report is accurate, carefully study my rebuttal. It is based on material found in the Report and/or on material in the Commission's possession.

My testimony is divided in three categories for clarity. The first addresses the section of S. 889 which prohibits encryption of PBS and AFRTS. The second part rebuts testimony that is untrue or misleading. The third part contains statements/material that supports my position that S. 889 should be passed immediately.

Quotes of verbal testimony and/or written statements are printed in condensed type. Regular quotation marks will be used for all other quoted material.

1/ The appendices referred to throughout this statement were not reproducible.

PART ONE

S. 889 proposes to amend SEC 3 Sec 705 of the Communications Act of 1934 (47 U.S.C. 605) new (c) (1) "No person shall encrypt or continue to encrypt satellite delivered Public Broadcasting Service programming intended for public viewing by retransmission by television broadcast stations. (2) No person shall encrypt or continue to encrypt satellite-delivered Armed Forces Radio and Television Service Programming, unless such encryption is required under multinational trade or copyright agreements to conform to United States laws." These two sections clearly preclude encryption which by definition means, to addressably encode a signal. Once encoded, a decoder is required before the signal can be seen and/or heard. Once encrypted, the decoder must be authorized individually (addressed) or as one of a group before the signal can be seen and/or heard.

PBS claims the VideoCipher II makes possible encoding and transmission of digital stereo sound (via satellite). Each PTV station needs at least one VC II decoder to receive and decode each signal.

Mr. Michael E. Hobbs, Senior V.P., Policy and Planning testified, Pg 1 P 3, At the outset, I would like to say once again that PBS has no plans to encrypt its regular program transmission. Pg 2 P 1, Our Board of Directors in March of this year [1987] reaffirmed its committment to continue to make a clear satellite transmission of all programs in the PBS National Program Service available throughout the country. PBS **REFUSES** to enumerate what programs constitute their regular program transmissions and/or the National Program Service. By so doing, they effectively retain total control over what they are obligated to keep in the clear. PBS cites examples in their press statement dated March 12, 1987, "The National Program Service includes those PBS programs, such as SESAME STREET, MASTERPIECE THEATER, NOVA, FRONTLINE, and GREAT PERFORMANCES, intended for audience viewing." These examples either represent the sum total of all programs in the NPS **OR** is this only a partial list? Why would PBS do that?

Pg 4 P 2 The units are custom-built for this purpose alone, so the market is quite limited, the cost is high, and replacement parts are difficult to obtain. I can make an equally accurate statement, "My 1975 television was built for this purpose alone, so the market is quite limited, and replacement parts are difficult to obtain". Both statements are true, but not accurate. The DATE system was built for digitizing stereo sound, the TV was built to receive and display pictures. The market for both is limited. Older parts are not always easy to obtain, but parts **ARE** available! Pg 5 cont' from Pg 4 ...less than half of PBS's member stations are able to receive DATE stereo transmissions today. **WHAT MR. HOBBs DOES NOT say is,** that while DATE was/is expensive, many member stations chose not to simulcast (to transmit, one audio channel with the TV picture and the other audio channel on a FM radio station) the decoded DATE signal to citizens who showed little interest in stereo. Mr. Hobbs failed to point out that while stereo is growing more popular and multichannel television sound, MTS

televisions are being produced and sold; stereo, even digital stereo, does not justify encoding a program, removing it from access by all who do not own VC II decoders! NBC, MTV, Nashville Network, Disney, ESPN, WTBS, USA Network, and PTL all distribute multichannel sound without having to encode their signal! APPENDIX # 3 A

Pg 5 P 1 ...This technology offers the greatest potential for an increased range of services by PBS. One of those services is superior stereo sound. NOTICE they did not name any others! True, the increased ranges of services WILL ONLY be available to paying customers! Pg 6 P 2 Thus, this new technology will enable PBS to reach out to large and long under-served sectors of the public who, due to visual impairments or language barriers, cannot now fully enjoy public television programming... Mr. Hobbs also fails to point out, PBS already (without using DATE) has the ability to use audio subcarriers, on satellite channels they own, to transmit (in the CLEAR) these more useful and enjoyable alternatives for the visually impaired and those not fluent in English.

Pg 7 P 1 ...a VC II commercial decoder appropriate for use at public television stations currently costs approximately $500... The VC II encryption equipment needed at each of PBS's five (5) uplinks cost $250,000 (+), times 5 = $1,250,000 (+). A competing system that **DOES NOT** ALTER (scramble) THE VIDEO costs $425 (in quanity) and the modulator (needed to send stereo to the satellite) costs $1,895 times 5 = $9,574. APPENDIX # 3 B With 182 member stations* and 5 uplinks, total cost for VC II encryption and decoding equipment is $1,341,000 plus. The competing system costs (no scrambling) $83,825, a savings to PBS, member stations and citizens of $1,254,175. This money surely can be used for better purposes. **REMEMBER** this less expensive technology DOES NOT alter the picture. Those who must use TVRO systems for access, would not need decoding equipment to enjoy PBS's programming. Other technologies are also available at comparable prices. *The 4/12/87 PBS press release states Pg 1 P 3, PBS's programs are distributed via satellite to 317 member stations,... Pg 2 P 3, But because of DATE's $11,000 cost per decoder, increasing obsolesence, and limited availability, only about 70 of PBS's 182 member licensees have been able to put DATE to use. Using the 317 member station figure VC II costs would be $1,408,500 the competing technology would cost $144,299 saving $1,264,201 (the cost of a good series).

Pg 8 P 1, Thus, PBS's use of this technology does not deny access to its National Program Service to any home dish owner. What concerns tax payers, is PBS's ability to use the VC II encryption equipment (already installed) to encrypt any/all PBS programs, services etc. not named in the NPS (NOVA & FRONTLINE etc.) list. P 2, In fact, the VC II is the best technology for delivering high quality stereo to home dishes. The FCC Report to Congress Pg 21 #150 states, "ABC seeks to transmit a signal free of distortion and believes that the current M/A-COM Video-Cipher II scrambling technology, 'will introduce some imperfections both in the audio and the video portions of the signal'". Not all owners of satellite systems nor of VC IIs have stereo equipment. Not all 319 PBS stations have (nor will have in the forseeable future) stereo transmission equipment!

Pg 10 P 1 **The prohibition on PBS, and its damage to our service, are severe, and are not necessary to achieve the intended benefit of this legislation.** S. 889 only precludes PBS's using the VC II to restrict access to their service(s). It does not prevent use of less expensive technology (that does not alter the video) that digitizes and/or provides multi-channel sound.

Pg 11 P 1 **...Congress already exercises oversight authority over the public broadcast system.** A letter to Senator McConnell from PBS Deputy General Counsel, Barbara Wellbery (a reply to my letter to Mr. Christensen 2/3/87) dated May 11, 1987 page 3 stated, "Finally, PBS is a private, nonprofit corporation and is financed by its members--local public television stations--to serve their needs in securing programming, interconnection, and other services. Since PBS is not a government agency, it is not subject to the Freedom of Information Act..." If PBS is so committed to the fullest possible dissemination of educational, cultural, entertainment, and outstanding public programming, WHY does PBS equivocate about access to their records? If the National Narrowcast Service, NNS, and other PBS Enterprises, Inc. projects generate revenues FINE let them. If access to such services must be restricted (encoded/encrypted) to market them, some alternative should be found, without claiming the VC II is needed to make stereo available to stations and viewers who can not afford the technology or do not want it.

The United States Congress created the Corporation for Public Broadcast, CPB, and the Public Broadcasting Service, PBS was inaugurated in 1967. PBS was to be the non-commercial, educational, cultural, and network alternative service with the fullest possible breadth that is intended to reach everyone, not just those who can afford it, not just those who are beyond cable's signal or converter price, and not just those who have to rely on an outmoded broadcast signal in places PBS and over-the-air television can not even reach.

Some claim PBS's "new directions" stray from Congress's mandate. Many say cuts in Congressional funding justify these changes. Others state Congress wants PBS to become self supporting and that PBS is only trying to comply with this mandate. A few claim PBS is simply growing as technology grows, i.e. encoding (scrambling, which alters PBS's uplinked signal so it is not viewable and there is no sound, all in the name of digital stereo.

Some of PBS's "new directions" are: leasing "unused" transponder time/capacity to others (without any public control in deciding what programs are not uplinked-resulting in unused transponder time); providing equipment, crews, and/or facilities (for a price) to others; uplinking certain programming which, by encrypting it, is only available to those who pay for it; selling programs and/or products (created with public monies) to the public - forcing citizens to subsidize the very items being sold to them; and collecting revenue via, enhanced advertising", where program sponsors create advertisments (as commercial network and independent television advertisers do) which are uplinked along with PBS's programming. These are only a few of the changes (those easily understood) that veer away from if not conflict with Public Broadcasting's Congressional mandate!

Following careful study of PBS's reply to the FCC's Notice of Inquiry 86-336, I provided a detailed rebuttal. Numerous letters have been written to CPB and PBS asking specific questions with either no reply or the "answers" were non-responsive coming many weeks later. PBS's recent press release promised to, "keep the National Program Service, NPS in the clear". It justified encryp$ion/encoding, (scrambling) of one or more feeds, and PBS refused to name all programs that make up the NPS. I have good reason to question their Congressional and public accountability. PBS's problems are deliniated in two TV GUIDE articles. APPENDIX # 4 I am providing copies for the record and I will furnish any additional information/documentation you request if the cost of copying and postage is prepaid. APPENDIX # 5

PBS faces, reduced funding, member stations have been shifted or dropped altogether from cable channels, program producers and sponsors are attracted by higher potential profits from network, cable, and independent television services. PBS is wrong to believe salvation will be assured by mimicking other commercial services. Money thus spent assures citizens that their contributions to PTV stations and their tax dollars will simply enable PBS to become a commercial, psuedo educational and cultural copy of networks, independents, and cable services, whose programming is intended to reach people with spendable income, offering advertising revenue with little/no regard for viewer's needs. PBS Enterprises Inc. concerns are potential profits and survival of its creator, "AMERICA'S FOURTH NETWORK", PBS!

It seems unpatriotic to question the United States Department of Defense, DOD. This seems especially true when the subject involves a service to our armed forces personnel stationed on bases around the world. **I AM NOT QUESTIONING THE VALUE OF AFRTS.** I am questioning the reason(s) and the claimed need for the proverbial $400 military screwdriver. This time the expenditure involves hundreds of thousands of dollars that will not, **CANNOT** accomplish the claimed objective(s).

ARMED FORCES RADIO and TELEVISION SERVICE SURRENDERS

The DOD, American Forces Information Service, AFIS, Armed Forces Radio and Television Service, AFRTS has provided radio programming to American forces for over 30 years. Following the advent of television, DOD expanded its mission to include TV programming. Radio transmissions travel thousands of miles, reaching most of the world. TV transmissions are limited to 75-100 miles. Origionally, all TV programs were distributed (via ship or plane) on film, and later on video tape, to AFRTS transmitters. Radio and TV signals travel at the speed of light, ships and even jets appear to crawl as they deliver programming compared to radio's/TV's speed of light.

Communications satellites made possible dependable instantaneous worldwide dissemination of radio and television signals. AFRTS uses this technology, permitting instantaneous distribution of recorded and live radio and TV programming to military personnel worldwide.

Most, if not all, programming used by AFRTS is copyrighted. It can not be used without authorization from the programmer/syndicator. According to Mr. Jordon E. Rizer, Director of AFIS, programming is available to AFRTS on the condition that it will only be available to American Armed Forces personnel, "or we will lose our programming." Programmers/syndicators limit access to material so they can sell it overseas in host (foreign) countries. Mr. Rizer states that AFRTS uses wired (cable) and, "very low-power transmitters and highly directional antennas pointed directly at U.S. military installations."

Satellite signals are available to all who own satellite receiving systems whether an individual or a business. Businesses such as hotels, restaurants, and even cable systems, sometimes use satellite signals illegally (without paying copyright or syndication fees).

Satellite systems outside the U.S., Canada, Caribbean, Central America, and/or northern South America can not receive AFRTS signals that are sent to Satcom F 2 for relay to Pacific & Atlantic international satellite systems. Taxpayers are now told we must pay for signals to be scrambled that are already protected by national and international copyright laws. Program owners/syndicators can, prosecute all who illegally use copyrighted material for profit. I call such commercial thieves, "**PIRATES**".

Mr. Rizer's letter of March 26, 1987 proffers justifications for AFRTS having to protect private property by encrypting AFRTS signals, at tax payer's expense. I have provided several (but not all) facts that refute Mr. Rizer's explanations.

Fact # 1- Regardless of distribution method (including delivery on video tape) programming is ultimately sent to U.S. military men and women in host countries via either wire (cable) or over-the-air (VHF and/or UHF) television. People in host countries have multi-standard televisions, designed to receive programming transmitted in a variety of formats, including the US NTSC format. AFRTS's over-air signals are easy to receive, while cable signals are harder to access. Cable systems with even a small emission (leak) transmit a weak signal (it litterally leaks from the cable like water from a hole in a hose). If an entity wishes to "steal" signals and distribute them, equipment is available that can amplify them, change their format (from NTSC to PAL or SECAM), and if need be, decode them!

Fact # 2- AFRTS programming can be received by anyone within range of the transmitter. Effective radiated power, ERP, depends on transmitter output power and antenna design expressed in watts. Height, weather, and terrain also influence how far away viewable signals can be received. There is no precise relationship between wattage (ERP) and distance a useable signal is available. Even a ten (10) watt signal can travel miles. Mr. Rizer claims AFRTS uses,"**very low-power transmitters**". The FCC limits U.S. low power transmissions to: VHF (Ch 2-13) ten (10) watts and UHF (Chs 14-83) one thousand (1,000) watts.

These limits do not apply outside the U. S. **BUT,** AFRTS transmits on VHF TV Ch 8 on the island of Okinawa Japan with 40,000 **watts** of power. AFRTS uses sixteen (16) transmitters in South Korea! APPENDIX #7.5 Five transmitters distribute AFRTS programming in the Philippines, two are **1,000 watt** units. AFRTS programming covers (litterally) the island of Cuba on Ch 8 with a 485 watt signal. Higher power would be used, but the signal would interfere with Ch 8 TV signals in Flordia! AFRTS has transmitters in West Germany; Wiesbaden Ch 22-1,000 W, Neighenburg on Ch 57-1,500 W, Berlin 2,000 W, Keisersalturan Ch 30-3,000W, and in Bitburg on Ch 27 using an 8,000 W transmitter. Three transmitters operate at the U.S. legal MAXIMUM, one below, one **EIGHT** times over, another **4,000 times above** the U.S. limit, and the balance **EXCEED** these limits. "VERY LOW-POWER INDEED"!

Fact # 3- Mr. Rizer says AFRTS must encrypt or programmers/syndicators will stop furnishing programs. To truely comply with these **DEMANDS** AFRTS must encrypt all signals, including over-the-air transmissions. This involves; [1]encoding, [2]uplinking, [3]downlinking, [4]decoding, [5] encoding (again), [6]transmission, [7]reception, [8]decoding (again), and [9]viewing on TV. Another method bypasses steps [4] and [5] saving equipment and money. APPENDIX # 6 According to Mr. Rizer, AFRTS only plans to use steps [1-4] before sending the signal "in the clear" on cable or over-the-air. HSD system costs have dropped, but overseas prices remain high, but high prices have not deterred theft of clear signals. B-MAC decoders may be harder to obtain, but no technology is inaccessible when one is willing to pay enough for it! Example, Toshiba sold "critical unavailable technology" to the Russians! Only the few individuals who own satellite systems, **who are not PIRATES,** will be denied access to AFRTS programs. Millions of tax dollars will be spent to stop/prevent a few thousand individuals from seeing AFRTS programming, while signal **PIRATES,** the bain of programmers and syndicators, will simply spend more money to make money by decoding encrypted singals and then use them as usual!

Fact # 4- Existing national and international laws protect the property rights of those who own/control programming. I sought government documents and information (under the Freedom of Information Act) several times without even the courtesy of a reply. APPENDIX # 7

AFRTS is an American information/propaganda service. This is not their purpose according to Mr. Rizer. DOD/AFRTS wants to send the American "message" to all citizens of host countries as well as to audiences in less friendly countries such as East Germany, East European (Communist block) countries, North Korea, Russia, and yes, even in China!

Mr. Rizer used Turner Broadcasting System, TBS, as an example. TBS wanted to market Cable News Network, CNN and Headline News to European customers. "They were obtaining them [programs] from AFRTS feed on SATNET and TBS wasn't making a dime." Mr. Rizer failed to explain that AFRTS uses all four (ABC, CBS, NBC, and CNN) **NOT** only

one network's programming. This variety avoids favoritism and is FREE ADVERTISING for Mr. Turner's CNN and Headline News. Both are 24 hour a day services. CNN subscribers expect full time access! DOD and/or Congress should stipulate equitable terms under which programming will be made available to U.S. servicemen and women around the world. Corporations should not threaten to withdraw access to programming and/or dictate terms under which programming will be made available to servicemen and women based on avarice. Their only concern is the profit motive not patrictism! Liberal tax credits are claimed by programmers and syndicators for programming used by AFRTS. AFRTS's programming tends to increase product (programs) value. Large scale **PRIACY** is easy to detect and prosecute under current national and international law.

An article on CNN was printed in the Sept., 1987 issue of FREQUENT FLYER written by Sam Staggs states, Pg 67 Col 3 P 3, "...thanks to...(AFRTS), CNN was already there. AFRTS delivers CNN and other porgrams to U.S. military installations around the world....CNN's fortuitous presence...-made it easier for Turner Broadcasting to sign formal agressments with hotels, embassies, and local cable systems... Those who help themselves to CNN without so much as a 'by your leave' are not thieves; rather, in the eyes of CNN's owner, they are accepting promotional material....,but CNN considers it a subtle way of winning friends-and hooking them. When the signal is eventually scrambled, everyone will pay up to avoid missing a single news flash." Mr. Staggs does not mention (or does not know) that CNN is available along with other programs to anyone who owns a TV in these foreign "markets". If Mr. Turner wants to sell CNN, it will have to be taken off AFRTS's over-the-air TV transmissions. CNN via 2,000, 3,000, 8,000, and **40,000 watt** transmitters is a **VERY EFFECTIVE WAY of, "winning friends and hooking them.", thanks to AFRTS!** Time prevented my getting reprint rights for this eight page article for the appendix.

PART TWO

Quotations from verbal or written testimony submitted to the Senate will be in condensed type. Other quotes will be bracketed by " marks. My rebuttal follows the order persons testified. Mr. Peter Pitsch, Chief of Staff FCC, testified first.

Pg 1 P 3 The available information suggests that HSD prices will be comparable to or below those paid by cable subscribers. Here the words suggests and will be say it all! The word comparable is inappropriate. Cable companies may sell TVRO equipment, but they do not provide (free) hardware. If a HSD owner is outside a cable company's franchise territory, we can not buy software (programming). Cable subscription prices cover hardware and programming. Pg 4 P 1, Scrambling is thus fundamentally a pro-consumer development, one that is likely to bring viewers new, popular, and diverse programming. Encryption restricts access not increases it. Revenues from subscriptions (newspapers, magazines, or TV programming) does not quarantee/promote any increase in quanity or quality.

Pg 4 P 2 To date, no American satellite cable programmer has indicated that it is considering another technology. Mr. Pitsch carefully qualifies his statement by using the word, cable. APPENDIX # 8 Pg 4 P 2 At this point, 32 program channels are scrambled in some manner using the VC II technology. More misinformation. This play on words, leads readers to conclude there are 32 scrambled services. WRONG, the 32 program channels are multiple feeds of the same services. There are only 12 programmers supplying scrambled services! Mr. Mooney stated, Pg 20 P 1, Mr. Chairman, the first cable program network scrambled only 18 months ago, and todate fewer than a dozen have done so. P 3 The report estimated that there were a total of 70 satellite-delivered services. Mr. Pitsch fails to mention that there are a number of other satellite delivered technologies including; facsimile, data, teletype, and over 120 audio channels (not counting SCPC services). Pg 5 P 1 While most of the scrambled services are available on an a la carte basis, several program packages have developed and more are likely to be created as additional basic services scramble their signals. Packages are now available from programmers and from cable operators; and one "third party" packager—that is, an entity that is neither a programmer nor cable operator—has firm plans to begin selling a package soon. Mr. Pitsch admits, when he states one "third party", that his earlier statement about, other sources, was inaccurate at best at worst a LIE!

Pg 6 P 1 Home Box Office has also indicated its interest in providing a program package. Home Box Office's inital plans called for transmitting the service [Festival] on the Ku band only and not offering it to HSDs. Mr. Pitsch confirms HBO has little concern about the HSD industry (except when we loudly complain about such discrimination!) Mr. Pitsch refers to Netlink's negotiation with the networks to provide retransmission of an affiliate of each network to HSD owners, but he FAILS to point out a similar service, Satellite Broadcast Network, SBN is being sued by the networks and the affiliates SBN uplinks. This is another example of the Commission's bias and selective use of information to oppose S. 889 by any means.

Pg 7 P 2 The National Rural Telecommunications Cooperative (NRTC), a third party packager,... The use of the letter a in this statement leads the reader to think the NRTC is one of several, NOT the only third party packager. Two other prospective third party packagers continue to work on assembling packages, but at this point they have not signed any contracts with programmerss. Mr. David Walford, CEO of Home Satellite Services and Mr. Chet Grochoski, V.P., Amway Corp. both prospective third party packagers, contradict Mr. Pitsch's statement. Mr. Grochoski stated in his letter to Charles Hewitt, President of SBCA dated June 19, 1987,

> "I have a file cabinet full of meeting and telephone conversation notes, correspondence, draft contracts, etc. But there is one thing I don't have in that file cabinet. I don't have even one signed contract. After ten months of extensive negotiating in good faith, not one contract."
> APPENDIX # 9

Even with impending legislation, MR. WALFORD AND MR. GROCHOSKI testified that no one would seriously negotiate contracts with them.

Pg 8 P 1 Several manufacturers have assembled promotional packages to be provided to purchasers of their integrated receiver decoders (IRDs). These packages simply provide programming that is available from other sources. They do not represent alternatives nor additions to the limited services available through other sources. Pg 8 P 2, Mr. Pitsch's statement about the package of programming available thorugh TBS emphasizes details of the package then he causually states, but recently put those plans on hold. Assuming the Turner package was significant enough to be mentioned, Mr. Pitsch has a flare for understatement! Pg 9 P 2, Thus, a de facto standard has already been chosen by the marketplace. Consumers need buy only one decoder. APPENDIX # 8 This statement is in direct conflict with his prior statement, Pg 4 P 2, Two services that do not serve cable systems...do use other systems. The World Wrestling Federation and Dodger Vision distribute programming to cable headends. Neither use the VC II. The issue was not and IS NOT SIGNAL DISTRIBUTION TO CABLE COMPANIES NOR TO CABLE SUBSCRIBERS. The subject IS HSD access to satellite services, third party marketing of programming, and reasonable pricing of all services NOT JUST cable programming! The REPORT admits HSD owners need more than one decoder. Pg 9 P 2 This does not rule out, nor should it, the chance of a quantum leap in technology leading to drastically improved quality and/or reduced cost. The carrot of reduced cost is old and limp. It has been used too many times by the FCC! The quantum leap in technology places owners of stand alone decoders and IRDs at risk. Such a change could instantly obsolete existing decoders and ruin consumers' investment in the VC II technology! One year ago Mr. Fowler, Chariman of the FCC assured the Senate that decoder and programming package prices would fall.

Electronic countermeasures mentioned by Mr. Pitsch, involve GIC's sending a signal by satellite to turn off those decoders that GIC THINKS are MOST LIKELY to be illegally receiving subscription programming. Decisions to turn off decoders without proof the decoder has been altered, violates our constitutional rights. Pg 14 P 1 Reads, Without examining individual decoders, it is impossible to tell with certainty if one has been altered. GIC claims to know of fewer than 50 "mistakes" in the process, i.e. decoders without "pirate" chips and which programmers had authorized [the decoder owner] to receive unscrambled programming that had been turned off by GIC under its countermeasures program. He continued, GIC is apparently trying to balance the need to protect the integrity of its encryption system against the possibility that some decoders without "pirate" chips attached may be deauthorized. Mr. Pitsch mentions,...design change[s] which really are nothing more than, potting, in which key components of the VC II module are encased in epoxy. This makes it more difficult to remove a chip from the decoder and to replace it with a "pirate" one. Solvents can dissolve the epoxy, rendering this design change useless! Mr. Pitsch stated, Pg 17 P 1, GIC is not likely to deauthorize decoders randomly or capriciously. GIC risks losing millions of dollars if programmers can not be convinced their product is secure while using the VC II. Therefore, GIC has no choice but to try anything they think will work or help. This puts owners of decoders, stand alones and IRDs, at the mercy of GIC. The authorization and deauthorization of VC II decoders are not covered by the rules and regulations of the Federal Communications Commission.

Mr. Mooney stated in his written testimony, Pg 1 P 2 The HSD business has stabilized and is growing again. Mr. Ergen, Mr. Walford, Mr. Grochoski, Mr. Finn, Mrs. Diane Davis and trade publications unmask Mr. Mooney's canard!

He also cited Viacom/Showtime's basic service package as an example of bargin rates available to HSD owners. Prorate the VC II's price over 3 years and $11 a month is added to HSD's costs making the monthly proramming price to $28.95 which is $5.28/month **MORE** than Mr. Mooney's average cable price! Pg 2 con't from Pg 1 S. 889 would only add needless cost for dish owners, depriving them of the relative bargin they enjoy today. Quite the contrary, it **ASSURES** HSD owners and cable subscribers that prices will be based on competitive not monopolistic pricing!

Pg 6 P 1 The history of the development of scrambling technology demonstrates that from the beginning the cable networks had a strong interest in and committment to serving the HSD market. P 2 Origionally HBO pursued development of a scrambling technology designed to thwart commercial theft of its product... A single decoder for Video Cipher I costs about $3,500. Video Cipher I remains an excellent technology except for its economic incompatibility with HSDs. Mr. Mooney stated Pg 1 P 1, NCTA represents over 2,400 cable telvision systems..., If only ten (10) feeds were encrypted using VC I's, each of the 2,400+ cable headends would have spent $35,000 (without allowing for even one backup/standy VC I). Many programmers agreed to provide (pay for) one decoder for each service cable companies subscribed to. Programmers willing to supply VC I's would have to allocate $8,400,000. HBO was not worried about consumer prices. The costs to them and to cable operators, 2,400+ X 4 (number of HBO & Cinemax feeds) X $3,500 = $33,600,000, **TOO MUCH MONEY!** Mr. Thomson, TCI stated Pg 6 P 6, The cable industry also ordered $60 million of Videocipher equipment for all of its headends shortly thereafter. Imagine how much money ($3,500/VC I divided by $500/VC II = 7. Therefore 7 X $60 million cost of VC IIs = **$420 MILLION WOULD HAVE BEEN SPENT IF VC Is HAD BEEN PURCHASED!**

Pg 7 P 3 To promote the growth of the HSD marketplace, M/A-COM established its multi-million dollar encryption and authorization facility in San Diego, California, a "free trade zone" so that any programmer, not just cable programmers, using Video Cipher II technology could be included in the same satellite data stream and therefore be receivable by any dish owner with a Video Cipher unit. Mr. Robert Thomson, V.P., TCI testified Pg 3 P 7, ...and the reluctance of programmers to allow us to authorize their programming for a dish owner directly through M/A-Com's DBS Authorization Center. Mr. Bob Phillips, CEO NRTC, testified Pg 8 P 5, NRTC is the first third-party packager to gain access to the DBS Authorization Center. And, from this experience we know that the terms controlling the availability and use of the Center are mandated, not negotiatied. HSDs are cable's **ONLY** competitor! Pg 9 P 2 More than 200,000 Video Cipher II units are in use and,... A very devious misstatement, Mr. Dunham testified on Pg 26 P 2, ...As of July, some 287,000 consumer stand-alone descramblers and 87,000 descrambler modules have have been shipped...There are some 205,000 consumer descramblers authorized as of the end of July... These figures mean 169,000 decoders are not accounted for. If one-half of 169,000 unauthorized decoders are in transit (in the shipping pipeline), 84,500 VC IIs would be <u>IN USE</u> but not authorized (**PIRATE DECODERS**)!

Pg 16 P 2 I would urge the members of the Subcommittee to bear in mind that very large numbers of program services, including many of the most popular cable services, are not scrambled and continue to be available to HSD owners for free. While some of these services may scramble in the future, others (including the cable industry's own C-SPAN and C-SPAN II) will remain unscrambled, providing HSD owners, unlike cable subscribers, with continued access to free service, and placing competitive pressure on prices charged to HSD owners for services that are scrambled: Mr. Mooney hopes to take advantage of subcommittee members'

lack of knowledge by listing eighty-six (86) program services which he claims are not scrambled.

MORE MISINFORMATION!

1. Twenty-six (26) are not even available to cable subscribers.
2. Twenty (20) are not for home reception (network feeds etc.)
3. Fourteen (14) are only occasional/part time services.
4. Nine (9) are test scrambling or have announced encryption dates.

So sixty-nine (69) of the eighty-six (86) services should not be listed in Mr. Mooney's example. Mr. Mooney's statement conflicts with Mr. Pitsch's claim, Pg 4 P 3, The report estimated that there were a total of 70 satellite-delivered services. A recent trade association compilation includes a substantially larger number of unscrambled services but contains some from Canada and some that transmit only a few hours per week. Pg 4 P 2, At this point, 32 program channels [not services] are scrambled in some manner using the VC II technology. Both use data to suit their purposes, but if one must be trusted, I believe Mr. Mooney, who is employed by the cable industry. Mr. Pitsch is infulenced both by the Administation he represents and pressure from cable interest who he must depend on for future employment!

Mr. Bertram W. Carp V.P. for Government Affairs, Turner Broadcasting System, Inc. claimed, Pg 4 P 2, ...and the only network to air live continuous coverage of this summer's Iran/contra hearings. I am glad to say PBS also provided the same coverage because I can not afford Mr. Turner's encrypted service (price of decoder and programming)!

Mr. Lawrence Dunham, Executive V.P. & General Manager of General Instrument Corporation, GIC, testified Pg 10 P 2, ...between M/a-COM and HBO, we purchased and tested over thirty different HTVRO receivers to test compatibility. His LIE is contradicted by HBO's submission to the FCC's Notice of Inquiry dated October 17, 1987 which states Pg 16 P 1,

> "In its 1984 agreement with M/A-COM for the VideoCipher II system, HBO specified 25 satellite receivers commonly used by cable television systems that were to be tested for compatibility. 14/ In fact, many more cable system receiver models were tested."

The footnote 14/ at the bottom of the page HBO names the systems tested. ONLY one manufacturer's product (3 models) was marketed for HSD use! TWENTY-TWO models were commercial receivers and claims of compatibility with HTVRO receivers was based on these commercial receivers. They were not manufactured nor marketed for home use!

Mr. Dunham/GIC counts on our politicians and/or their staff not being knowledgeable about technical matters. He claims Pg 21 P 2, Some of these modifications [pirate chips] may have been made by consumers themselves. I have over fourteen (14) years electronic experience, excellent tools and equipment and sufficient knowledge to make the suggested modifications. BUT I would not spend $400+ for a decoder and $250 or more for a chip, attempt to desolder, remove the origional chip, install the pirate chip, and solder it back into the circuit! That does not mean no consumer(s) would try. An example of an equally inaccurate statement would be, "Some heart surgeries may be performed by consumers." While anything is possible, it is highly UNLIKELY!

Mr. Dunham claims Pg 26 P 2, As of the end of July, some 287,000 consumer stand-alone decoders and 87,000 descramblers modules have been shipped... There are some 205,000 consumer descramblers authorized as of the end of July... According to GIC's own figures 169,000 decoders are not authorized. Some are in transit (the shipping pipeline), stocked by distributors and/or dealers, others may be purchased but not in use, and the balance are in use BUT NOT AUTHORIZED making them PIRATE DECODERS! If one half, 84,500 are not in use, that leaves another **84,500** receiving programming without any programmer being paid a paid a penny for their service! ONLY GIC PROFITS FROM THE VC II!

PART THREE

I am pleased to say these hearings have for the first time produced more accurate information pertaining to the HSD industry than all previous hearing(s)! I am submitting only 4 ½ pages of rebuttal. It is only a summary of contradictory or misleading testimony (not counting PBS). Senators and their staff have at least a 50/50 chance of getting a true picture of the state of the HSD industry and the urgent need for immediate markup of S. 889.

Mr. Pitsch admits Pg 16 P 3, Without examining individual decoders, it is impossible to tell with certainty if one has been altered. GIC must litterally guess which decoders have been illegally altered, a guess is a guess no matter how carefully researched, thought out, and/or calculated! Pg 19 P 3, The plans of Netlink, whose package is not yet being sold to HSD households,... Such plans are just that, plans not facts until one and one-half years after the service starts. HBO etc. still urges Congress not to conclude the HSD industry needs help the facts not withstanding!

Much to my surprise, even Mr. Mooney made two accurate statements. Pg 1 P 2, The subcommittee has before it today S 889, a bill to regulate marketing practices for satellite-delivered television programming. My testimony concerns access to a variety of satellite delivered services, not just television programming is one, which is not the ONLY service available thanks to satellite technology. He inadvertently helped document that the HSD industry is not working by stating Pg 20 P 1, Mr. Chairman, the first cable program network scrambled only 18 months ago, and to date fewer than a dozen have done so. If scrambling is such a pro-consumer development, and the HSD industry is healthy, many other cable program networks would already have scrambled!

Mr. Frederick W. Finn, HSTA stated Pg 1 P 2, That marketplace is in a state of shambles. P 3, ...but they do so at a price of up to six times or more the fee charged to cable systems. Pg 2 cont' from Pg 1, Finally, the quoted rates do not include the exhorbitant prices for the descrambler of $395-600 if one can be found. P 2 Even the basic question of access by home dish owners to satellite programming is in question with the recent indecision of HBO whether to sell its new Ku-Band services to home dish owners. P 3 cont' from Pg 2, This week General Instruments announced that it paid twenty million dollars to settle a law suit over this device.

Mr. Thomson's/TCI furnished additional documentation that substantiates points made by myself and/or others. Pg 1 P 2, ...whose residents were unable to receive adequate broadcast signals off-air. I respectfully remind you that the lack of access to off-air broadcast signals was

the impetus for the birth of the cable industry. To be profitable, cable signal delivery requires high housing density and subscription penetration. Where housing density or penetration is low, residents without access to off-air signals is a non-issue (for cable). HSD, CABLE'S ONLY COMPETITOR can furnish not only off-air signals, but a variety of other electronic services, including cable programming, to one home or one thousand homes at cost savings many times that of cable installation! He also substantiated that the HSD industry is not working Pg 3 P 7, ..and the reluctance of programmers to allow us to authorize for a dish owner directly through M/A-COM's DBS Authorization Center.

Mr. Bob Phillips, CEO NRTC, stated Pg 5 P 6 Last year HBO had advised us verbly that they wish to pursue a direct marketing campaign and mentioned that they may be "at risk" selling to us because they felt their cable customers might become quite concerned. Pg 7 P 1, We have pursued continued dialogue with them but Disney has made no commitment to NRTC... Pg 8, In fact, some of the contracts we have entered into exceed the cable wholesale price by 500 to 700 percent or more!. We see absolutely no justification for this tremendous price differential. Pg 5, And, from this experience we know that the terms controlling the availability and use of the Center are mandated, not negoiated. Pg 9 P 9, Rural America knows well that deregulated environments do not help those with fewer competitive advantages. Sparsely-populated areas do not always share in the benefits of deregulation.

Mr. David Wolford, President HSS, confirmed Pg 3 P 1, More than a year and a half later the industry is at a virtual standstill. Pg 4 P 1, The reality is that today's consumer does not have competitive programming sources from which to choose. A dish owner who decides to purchase a descrambler and subscribe to programming services can choose from only two types of suppliers: Programmers...Cable companies

Mr. Dunham also offered information corroberating my points Pg 13 P 2, Another aspect of our contracts requires us to license second-source manufacturers of the desambler modules. Channel Master is now licensed as a second source. Mr. Dunham speaks of manufacturers, but Channel Master is only ONE manufacturer[s] !

Mr. Ergen's written testimony deserves your close attention. Pg 3 P 2, A second reason for this shortage may have been that G.I. understood all too well the industry demand. The critical shortage of Videcipher decoders benefited G.I. in two ways: 1. GIC increased its share of the receiver and IRD market. 2. Enabled GIC to raise VC II prices. Pg. 10 cont' from Pg 9, In addition honest satellite dealers have been faced with the difficult choice of going out of business or condoning piracy. Pg 12 P 3, The legislation before you involves an issue of greater importance than a workable descrambling marketplace, it concerns itself with the denial of the public's right and access to information under the 1st Amendment. It is inarguable the telecommunication industry is "affected with a public interest" and Congress has retroactively mandated compulsory licensing in other industries impressed with such interest".[16]

If any written testimony should be read carefully cover to cover, it is Mrs. Diane Davis', a consumer from St. Joe Arkansas. She provides poignant observations that only a consumer can furnish Congress. To cite/quote portions of her testimony would require my retyping it from cover to cover. She dispels myths that our commercial networks perpetuated concerning the size (numbers) of their viewing audience, the nature of their satellite feeds, the claimed potential harm to affiliates if their programming is intercepted by HSD viewers, and the value of translators in solving the grey/white area problems. She explains why other aspects of S. 889 are important and she urges prompt markup and immediate passage.

CONCLUSION

After two years of research, training, examination of copious material submitted to the FCC and all prior hearings, and 14 years of experience in the electronics industry, I feel qualified to share my conclusions regarding issues raised by H.R. 1885 and S. 889.

Direct delivery to the home via satellite of many forms of electronic information and entertainment is now a fact of life! Many only think TVRO/HSDs is only a means of getting cable television programming to those who own satellite receiving systems. Even if this is accurate, the HSD industry cable's only competitor! This is especially important since cable has been deregulated and is free to carry (or refuse to carry) what they wish and to charge any price they desire! Fifteen years ago my friends laughed when I told them I banked by phone! Within five years, I will be able to bank by satellite, you already can shop via satellite. TV programming and audio subcarriers on satellite are almost ten years old. HSD owners may have purchased systems to get access to networks (some for the first time) or other services. You commit a critical error if you can not see beyond what is available now to what will BE!

Those who compare HSD program subscription prices to those cable subscribers pay seek to compare lemons to watermelons. While both are fruit, the similarity ends there. Clearly, the price of a lemon would not be described as "competitive" if it were equal or close to the price of a watermelon! Most people are familiar with both fruits and are unlikely to be easily confused, but the HSD industry, is complex and constantly evolving, requiring constant study and timely information if intelligent decisions are to be made.

Rather than repeat my rebuttal of the erroneous, inaccurate, misleading, and intentional misrepresentations to our Congress, I ask that you, as our elected representative seek an appropriate "second opinion". If a doctor of internal medicine recommends you undergo major surgery, he should urge you to seek a "second opinion". Would you ask your doctor's partner (who shares his revenue)? Or, would you go to an ophthalmologist for the second opinion? PLEASE study material submitted by myself and others. We do not represent established money interests that often depend on vertically integrated corporations or their trade groups for paycheck(s).

S. 889 while far from perfect, represents an important step in the right direction. The PBS and AFRTS portions should be strengthened. It should apply to all signals, not just 'satellite delivered TV programming. It should apply to C, Ku, and any other frequency used to deliver data, infromation, news, education, entertainment, etc. Whatever technology is used to restrict access to signals, should be available to all who wish to manufacture equipment that enables paying subscribers to access the signals. PLEASE PASS S. 889

Respectfully submitted,

Ms. Robin Adair

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DEPARTMENT OF DEFENSE
AMERICAN FORCES INFORMATION SERVICE
601 N. FAIRFAX ST., ALEXANDRIA, VA 22314-2007

June 15, 1987

Operating elements

Armed Forces Radio and Television Service

American Forces Press and Publications Service

Defense Audiovisual Policy

Mr. Tom Cohen
Senate Committee on Commerce,
Science, and Transportation
SD-508 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Mr. Cohen:

As the Director of the Armed Forces Radio and Television Service, I am concerned over proposed legislation which would prohibit the encryption of Armed Forces Radio and Television Service (AFRTS) programming. I believe that I would be remiss in my job if I did not take this opportunity to advise you of the issues involved.

The Congress and the Department of Defense (DoD) have charged AFRTS with the mission of providing U.S. military commanders with a means of communicating important information to DoD personnel and their families serving outside the continental United States. This vital information is provided through world, national, military department, local command, community, and host nation news. It is also provided through news analysis and commentary, public affairs programs, and spot announcements--what you might think of as military "commercials"--on subjects important to our audience overseas.

The way we ensure we have the largest possible audience for our internal message is to place it in a broadcast schedule containing most of the same entertainment and sports programs we're able to view here in the States.

We're fortunate that in most countries where our people serve, host governments have given us permission to use their airwaves to broadcast our entertainment and information programming. In some countries, governments are resentful of the "invasion" of American culture by way of radio and television and have allowed us to serve our audience only by cable TV.

All of the television entertainment programs we offer, such as "Magnum P.I.," "The Cosby Show," and "Cheers," are provided to our stations overseas on videotape. These programs are acquired from program syndicators, commercial television networks, and other suppliers at extremely low cost by our

Broadcast Center in Los Angeles. Most often, the cost to the taxpayer is no more than the program owners' administrative costs (duplication and mailing fees, etc.). This is far less than the price a commercial TV station in the U.S. would have to pay for the same programs. We do **NOT** own these programs nor do we have the authority to make them available to stateside audiences.

Our program suppliers place upon us the requirement that we limit the distribution of those programs to only DoD personnel overseas. Because program piracy is such a problem, we have not used our satellite network to deliver entertainment programs to our stations overseas. In fact, in our agreements with Orion Pictures, Warner Brothers, Disney, and MGM/United Artists, we are prohibited from using satellite to distribute their products overseas.

Until the advent of the AFRTS Satellite Network (SATNET) in 1979, all of the sports and time-sensitive programs (Academy Awards and Grammy Awards shows, etc.) were also distributed to our stations overseas by videotape. As a result, network news programs and major events, such as the World Series and the Super Bowl, were seen in some AFRTS service locations days or weeks after the event. We wanted a method to deliver these time-sensitive programs to the stations overseas as they were happening. It was for that purpose that AFRTS began SATNET.

SATNET provides our military overseas TV outlets with television network newscasts, live network coverage of presidential press conferences and speeches, sports, and other "perishable" programs. These are the same television programs you can receive on your television set in your home. There are a few special military oriented programs we provide to our audience by satellite; however, many of these are made available to cable operators and television stations throughout the United States ("Navy News This Week," for example). The fact that citizens within the U.S. are able to see these satellite transmissions with home satellite dishes is a result of electronic media characteristics. AFRTS does not compete for audiences in the U.S. with any other broadcast facility or organization.

So why encrypt our overseas satellite feeds? Scrambling the SATNET signals on our satellites is being investigated as a means of ensuring that we can continue to receive programming. By ensuring that pirates in foreign countries cannot steal programming from our satellites and use it without payment to the program owners, we protect our own continued use of the programming.

A couple of recent cases are worthy of noting. Cable News Network (CNN) has begun an aggressive marketing effort to sell their programming to hotels in Europe for broadcast on their in-house cable systems. These programs would be delivered to the hotels via international satellite. The sales department at Turner Broadcasting System (TBS) was quite distressed to find that many hotels were already carrying these programs on in-house cable systems. They were obtaining them from the AFRTS feeds on SATNET, and TBS wasn't making a dime. The people at Turner have made it clear that if we want to continue to obtain their programs for our audience overseas, we have to take actions to prevent piracy.

It wasn't just TBS who made such demands. The people at NBC and at ESPN also have told us to begin aggressive actions to prevent piracy of their products. Just recently, our rights to air the Grammy Awards show in Germany were withdrawn by the program supplier because we couldn't guarantee the program would not be pirated. Also, we were not permitted to carry the finals of the World Cup soccer matches in the Philippines for the same reason.

AFRTS began investigating different encryption technologies to determine which would be the most secure at the least expense to the taxpayer. In general, AFRTS would scramble only the satellite signals, not the retransmission of programs from our stations overseas. Thus, the DoD audience overseas will not require any type of decoder to receive our programs.

When our programs are aired overseas, they are broadcast in U.S. NTSC standard, which immediately restricts their availability to foreign audiences where PAL is the prevalent broadcast standard. To further prevent the unauthorized reception of our signal, AFRTS uses very low power transmitters and highly directional antennas pointed directly at U.S. military installations.

Thus far, DoD has expended no funds on encryption testing or research. Private industry has been conducting vigorous research into a number of encryption technologies, which we have watched with great interest. When, and if, AFRTS does encrypt its SATNET service, we will most likely choose the best and most state-of-the-art of these technologies. A method of encryption has not been selected at this time nor has a date been established when AFRTS would begin encryption of its overseas feeds.

If encryption does begin, we will not be supplying descramblers for private citizens in the U.S. The only

decoders that will be purchased will be for our overseas TV stations. Those systems will be paid for out of military funds appropriated by the Congress. No specific request for funds to encrypt our satellite feeds has yet been made.

We will not be using tax dollars to deny American citizens the opportunity to watch what they have paid for. The fact is that we have never paid the broadcast industry for authority to distribute or make available programs for viewing in the United States.

In conclusion, I wish to reiterate that our only purpose in encrypting our AFRTS satellite signals is to ensure that we will continue to receive U.S. television programming from our program suppliers at nominal cost. To have this programming denied to our approximately 1.5 million service men and women serving overseas and at sea, many in remote and isolated locations, would be a devastating blow to their morale.

Very respectfully,

Jordan E. Rizer
Director

MOTION PICTURE ASSOCIATION
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JACK VALENTI
PRESIDENT
AND
CHIEF EXECUTIVE OFFICER

July 29, 1987

The Honorable Daniel K. Inouye
Chairman
The Communications Subcommittee of
the Senate Commerce, Science, and Transportation Committee
SH-227 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

I hereby request that the following comments of the Motion Picture Association of America, Inc. (MPAA) 1/ be made a formal part of the Subcommittee's hearing record on S. 889, the Satellite Television Fair Marketing Act of 1987, introduced by Senator Gore on March 31, 1987.

I. Introduction

Senator Gore and his colleagues deserve the applause and support of all those who believe in the competitive spirit of the American marketplace. They are to be commended for their ongoing efforts to foster the TVRO industry -- an emerging, new, consumer-benefitting communications delivery system.

MPAA supports, whole-heartedly, the primary objectives of S. 889. Yes, we have concerns about certain of the provisions in the bill. However, we are confident that reasonable revisions can be made to banish our anxieties.

1/ The member companies of MPAA are: Columbia Pictures Industries, Inc.; The Walt Disney Company; De Laurentiis Entertainment Group, Inc.; MGM/UA Communications Co.; Orion Pictures Corporation; Paramount Pictures Corporation; Twentieth Century Fox Film Corporation; Universal City Studios, Inc.; and Warner Bros. Inc.

But it is the fundamental objectives of S. 889 to which we offer our passionate support.

Those objectives can be stated simply:

(1) to make absolutely sure that TVRO owners have broad access to scrambled satellite-delivered programs; and

(2) to ensure that the TVRO marketplace develops in an open and competitive manner and that in no circumstance can this fledgling industry be allowed to become the province of giant multiple system cable operators (MSOs), dominated and controlled by them to the ultimate exile of this new delivery system.

There is no doubt that the giant cable MSOs, growing in revenues and cash flow, ownership concentration and power, freed from all restrictions except those that serve their own purposes, view all competition in the delivery of non-broadcast signals to consumers with disdain.

"Competition" is a word that the giant MSOs find unappealing. It intrudes on their ability to charge subscribers ever higher and higher rates. It offers a choice to consumers now virtually barren of choice. It can force the giant MSOs to pay sensitive attention to the public they are supposed to serve, an obligation more honored in the breach than in the acceptance.

But while these giant entities loathe all competition -- b it from Multichannel Multipoint Distribution Services (MMDS), Satellite Master Antenna Systems (SMATV) or technologies yet undreamed of -- it is the direct delivery of satellite-delivered programming to the home that they view as the singular enemy. This is the one technology which has the ability to leap beyond cable wires and head-ends to go directly to the consumer, potentially at prices less expensive to consumers than cable operators choose to charge.

There should be no doubt about the giant MSOs' agenda: they want to stifle the TVRO industry and all others who want to deliver non-broadcast programs to consumers. Congress must recognize the fragility of cable's emerging competitors and, where necessary and appropriate, take measured action to spur the marketplace. Otherwise these giant MSOs, all-powerful, unregulated, unsupervised monopolies, will surely snap the fiscal neck of all those who threaten their "monopolistic annuity." The consumer is, of course, the obvious loser in this mismatch. It is the consumer who, in the absence of competition, will be gouged in the pocketbook and denied the choice otherwise afforded him by the bounty of new technology.

What the giant MSOs say, with benign and Machiavellian irony, is that "TVRO, MMDS and SMATV should only complement cable service, not compete with it. We know best what's good for consumers; we can serve them more properly." If Homer were alive today, he would be able to testify to the absurdity of this claim, since it was he who invented the Trojan Horse.

What S. 889's title ought to be is AN ACT FOR THE PRESERVATION OF COMPETITION SO THAT THE CONSUMER IS RIGHTLY SERVED. Unregulated, unsupervised monopolies have never, in all the recorded history of the world, benefitted the consumer. Competition is good for consumers. Unregulated monopolies are bad for consumers. That is the truth that has survived the test of time. It is sturdily alive today. And it is from that truth that S. 889 draws its strength and purpose.

II. Regrettably, Today's TVRO Marketplace is Devoid of Real Competition.

A year ago I appeared before this Subcommittee and expressed the hope and expectation that the budding competition between and among deliverers of programming to TVROs (e.g., pay-TV services such as HBO/Cinemax, cable operators, and third-party distributors independent of either cable systems or MSO-controlled cable program services) would come to full flower, thus negating the need for legislative intervention by this Subcommittee.

At that time, I stated that when Congress enacted Section 705 of the Communications Act in 1984, it established an adequate legislative foundation for the marketplace to deliver satellite-delivered cable programming to TVRO owners, and that enactment of bills then pending before this Subcommittee was unnecessary.[2/]

Unfortunately, in certain key aspects, the marketplace has not continued to grow as anticipated. As a result, there appears to be a need today for narrowly crafted legislation along the lines of S. 889 to inject true competition into the marketplace.

2/ I did point out, however, that MPAA supported legislation to offset the discriminatory effect of Section 111 of the Copyright Act that continues to permit cable operators to retransmit scrambled superstations, but denies access to these programs to TVRO owners. MPAA continues to support legislative efforts to fashion a temporary mechanism to permit TVRO owners to view scrambled superstation programming, while providing some compensation to programmers.

Most important, last year we envisioned the entry into the marketplace of several independent program distributors who would introduce real competition into the delivery of scrambled programming to TVRO owners. We viewed such a development as crucial if the cable industry's tightening stranglehold on the delivery of these programs to TVRO owners were to be broken.

This has not happened.

Independent distributors --distributors not controlled or owned by the cable industry -- are having a very tough time.

For example, a year after the National Rural Telecommunications Co-Op (NRTC) announced that it was putting together a full package of programming for TVRO owners, the plan is still incomplete.

Earlier this month, a representative of NRTC told the House Telecommunications Subcommittee that the two leading movie channels, HBO/Cinemax (affiliated with American Television and Communications (ATC), the second largest MSO) and Showtime/The Movie Channel (affiliated with Viacom, the ninth largest MSO) "have expressed little interest in dealing with NRTC." HBO also told NRTC that "they [HBO] may be 'at risk' selling to us because they felt their cable customers might become quite concerned."

Similar experiences were recited at the House hearing by the head of a prospective third party packager, David Wolford of Home Satellite Services (HSS), who reported that neither Viacom nor HBO would "respond [to inquiries about their service] in spite of repeated attempts [by HSS] to set up meetings and pursue negotiations."

Other independent concerns, including such a seemingly strong competitor as Amway, have failed to put together a program package for TVRO owners.[3/]

The bottom line is this: just about anywhere the TVRO owner turns for scrambled satellite-delivered programming, the large hand of cable is present.

3/ My comments should not be taken to suggest that MPAA believes that any of the aforementioned prospective independent parties would or would not be appropriate, financially sound distributors. We have no way of making such a determination. We do, however, take note that there are no third-party distributors operating in the marketplace today.

For instance, virtually without exception, the only program packages available to TVRO owners are put together either by program services affiliated with large MSOs (e.g., Showtime/The Movie Channel) or by MSO's themselves (e.g., Tele-Communications, Inc., [TCI], the largest MSO in the nation; Times-Mirror Cable, the 12th largest MSO; United Cable and NewChannels all have their own program packages). In neither case does the distributor have an interest in the growth of a healthy TVRO industry, marked by robust competition between and among deliverers of programming to TVRO homes.4/

There is simply no place for independent distributors in the cable industry's scheme of things. That should surprise no one. The giant MSOs have no interest in seeing their competitors grow, prosper, and, in due course, take on their own identity, separate and apart from the cable industry. The cable behemoths want to control and eventually devour their competitors. They want to become the sole source for the delivery of non-broadcast programs to consumers. With each passing day, the risk increases that they will be able to do just that. This is a risk the public cannot afford. There are compelling reasons for the government to step in and take measured action to deny cable its conquest of all competition.

III. The Threat of Cable

At last year's hearing, I expressed serious concern about the cable industry becoming more powerful, more profitable and more concentrated. I noted that these developments greatly enhance cable's potential to control TVRO owner access to satellite-delivered programming and to stifle the growth of the TVRO industry and its other multi-channel competitors. Nothing in the intervening year has lessened my concern. In fact, the situation has worsened dramatically.

Cable is a major player in the electronic video marketplace.

No longer is cable a fledgling industry. The "Mom and Pop" era is over. Cable is now in the forefront of communications industry players; it has vast resources and its financial outlook is glowing. A few salient facts give a sense of just how well

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4/ The TVRO owner also runs straight into cable interests when he tries to purchase the right to view either of the two dominant pay services, HBO/Cinemax (ATC) and Showtime/The Movie Channel (Viacom) on an à la carte basis. Both of these premium services are available to TVRO homes à la carte only directly from the program service itself or from a cable operator.

the cable industry is doing in 1987.

Just eleven years ago, in 1976, total cable revenues stood at only $975 million. This year, cable revenues will reach $16 billion. On a revenue basis that makes cable roughly comparable in size to the entire broadcast television industry!

In 1975, cable television served barely 9.8 million subscribers, or 14% of all American television households. Cable penetration (i.e., availability to potential subscribers) was then only 29%. By 1986, cable's penetration neared 80% of American TV households, and cable counted some 42 million subscribers. That represents nearly 50% of all TV households!

In addition, the value of cable systems continues to skyrocket. The per-subscriber price for cable systems has jumped from a typical price of $1,000 per subscriber in early 1985 to $2,000 or more per subscriber today. For example, recently Cablevision Systems Corporation, agreed to acquire the Adams-Russell Company, a publicly held cable concern based in Waltham, Mass. for $2,089 per subscriber. One analyst predicts that "we'll see way in excess of $2,000 per sub -- possibly from $2,500 to $3,000 per sub in some markets."5/

Moreover, as a result of the Cable Communications Policy Act of 1984, the cable industry is now free to charge subscribers whatever the market will bear. And cable is doing just that. A recent report by the Paul Kagan organization indicates that among the hundreds of cable systems revising their basic subscriber rates coincident with deregulation in the first several months of 1987, the average rate increase was over 24%. And there are many instances of cable systems, immune from competition, hiking their rates by 40, 50, 60% or more.

No wonder Wall Street is so bullish on cable properties as investments. As Bear Stearns, one of Wall Street's most respected firms, has noted, cable has a "monopolistic annuity."

Concentration of System Ownership.

Ownership of local cable TV systems has become alarmingly concentrated over the last few years in the hands of a small band of giant MSOs. This concentration has put enormous resources in the hands of these giant corporations.

5/ Multichannel News (July 13, 1987) at 58.

Today, the top five MSOs own, partially own, or manage cable systems serving more than 46% of the nation's 42 million cable TV subscribers, and the top ten MSOs control access to more than 60%. TCI alone controls service to more than 22% of cable subscribers.

MSO-Affiliated Program Services.

Large MSO's now hold significant interests in both basic and premium cable program services and are aggressively acquiring more. For example:

* Time, Inc., which owns ATC, the second largest MSO, owns three pay cable services, including HBO and Cinemax.

* Viacom, the ninth largest MSO, owns in full four leading pay cable services, including Showtime/The Movie Channel, and four basic cable services, including MTV.

* A "consortium" of MSOs, including TCI, and others, now own more than a 1/3 interest in Turner Broadcasting (TBS), which in turn owns CNN, Headline News, and WTBS.

* In addition to its interest in TBS, TCI also owns an interest in seven other cable services, including Black Entertainment Television and The Discovery Channel.

Cable Television Systems are De Facto Monopolies.

These increasing levels of concentration in system ownership and programming control are especially troubling in an industry made up of **de facto** monopolies in communities throughout the country.

Let there be no mistake about it. The cable television industry enjoys a **de facto** monopoly on the local level.

It is a fact that virtually all of the 42 million cable subscribers in this country have only one choice for broadband communication services.[6/] Consumers must grin and bear the services offered and the unregulated rates charged by the local operator. If they want local and distant TV signals, advertiser-

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6/ It is estimated that of the approximately 7,000 American communities with cable service, only 30 or 4/10 of 1% are served by competing cable systems. And in those cases where a cable system competitor has attempted an "overbuild," the incumbent operator has routinely mounted challenges in the courts or local legislative bodies to keep out the unwanted competition.

supported cable network programming and subscription movie and sports channels, they must subscribe to the local cable system. There is simply no alternative.

Significantly, now that the Cable Communications Policy Act of 1984 has freed cable from government-imposed regulations, it stands as one of the few, if not the only, unregulated, unsupervised monopolies in existence.

Anti-Competitive Concerns in the Cable Television Industry.

The confluence of these factors -- ownership concentration, programming control and de facto local monopolies -- gives the cable industry the ability to act anti-competitively. Taken together, these factors underscore the cable industry's vast potential to abuse its monopoly-based market power, overwhelming its competitors and harming consumers. For example:

* the rapid rise in cable system ownership concentration poses a direct threat to the diversity of program services available to the public. The largest MSOs are now able to use their excessive power to control the entry of new cable program services into the marketplace. New cable networks know that unless they meet the demands of a giant MSO they simply cannot reach enough subscribers to even get their service off the ground;7/

* major MSOs can use their inordinate market power to garner programming at lower costs than those charged smaller cable operators, and they do not pass on savings to subscribers;8/

7/ For example, TCI's refusal to carry TBS's proposed music channel and NBC's proposed cable news channel have been widely cited as reasons why these proposed networks never made it. See, e.g., "Tele-Communications Sets Cable-TV Agenda," The Wall Street Journal (February 11, 1986), at 6.

8/ Not surprisingly, these "bulk discounts" to MSOs have drawn the ire of smaller cable systems. Steven Effros, head of the Community Antenna Television Association, has suggested that the "bulk discount" arrangements in which smaller independents pay up to 10 times more per subscriber than their MSO-owned counterparts, should not be allowed to continue. Cable Television Business (July 15, 1986), at 35-36.

* aggressive movement by the large MSOs into program production and distribution inexorably leads to favoritism for those cable networks in which cable operators have a direct financial interest, and can provide a disincentive for the entry of non-MSO controlled program services into the marketplace;9/

* in addition, their affiliation with program services gives large MSOs the ability and the incentive to deny programming to SMATV and MMDS operators seeking to compete with cable in the delivery of non-broadcast programs to consumers.10/

IV. There is a Need for Narrowly Crafted Legislation to Promote Competition in the Delivery of Satellite-Delivered Programming to TVRO Owners.

MPAA has long asserted, and continues today to believe, that the marketplace should be free to operate on its own, unencumbered by governmental restraints. Nonetheless, we recognize that there are times when the government must intervene in a careful and reasonable way to eliminate impediments to a free and competitive marketplace.

In our view, the threat posed by the increasingly concentrated and powerful cable industry to the non-broadcast video marketplace in general, and the TVRO industry in particular, warrants serious governmental scrutiny and prompt, measured intervention.

9/ Apparent favoritism by MSOs for their own program services is not going unchallenged by irate consumers. Cable subscribers in Manhattan have gone to court to challenge the ATC-owned cable operator's policy of carrying HBO and Cinemax (who share the same corporate parent as ATC) to the exclusion of other competitive pay services, including Showtime/The Movie Channel.

10/ SMATV and MMDS operators encounter a variety of problems in dealing with satellite-delivered program services. An MMDS operator in Cleveland was able to offer Showtime to his customers only after going to court. Moreover, a SMATV operator in Rochester, New York is now in court seeking the right to sell HBO and Cinemax to its subscribers, alleging that both HBO and the local ATC-affiliated cable operator have refused to deal with him. In addition, new MMDS operators run smack into HBO's written policy of not "entering into any new MDS affiliations."

Congress noted at the time it adopted the Cable Act that the cable industry must not receive "an unfair competitive advantage in the delivery of video programming." Governmental action now in this area would sustain what has long been our national communications policy -- to "promote[] the growth and development of alternative delivery systems for these [video] services, such as DBS, SMATV and subscription television." Congress firmly stated that "[t]he public interest is served by this competition, and it should continue."11/

We believe that the competition to the cable industry provided by these alternative delivery systems is in dire jeopardy. It may disappear entirely, never to return, if the federal government does not take decisive, affirmative steps to rein in cable's threatened domination of its competitors.

Legislation along the lines proposed by Senator Gore, with certain modifications, is an important first step in this process -- a process that we believe should not only involve this Subcommittee and its counterpart in the House, but others as well, including the Senate Judiciary Subcommittee on Antitrust, Monopolies and Business Rights and the House Judiciary Subcommittee on Monopolies and Commercial Law.

MPAA is convinced that a legislative response to the problems now confronting the TVRO industry is in order. Such a response can be acceptable only if it is narrowly tailored to address these specific problems. Therefore, we can support S. 889 if the following fundamental points are satisfactorily addressed in the bill:

1. The legislation must be narrowly crafted to promote the growth of truly independent distributors of satellite-delivered programming to TVRO owners -- distributors free of ties to either cable operators or cable program services controlled by large MSOs.

The bill's "independent distributor" provisions should attach whenever a program service encrypts their programs and uses any other party (including a cable operator) to distribute its signal to TVRO owners. In such instances, the encrypter also would be required also to deal with any other third party meeting reasonable financial and character criteria, established in good faith by the program service and applied in a non-discriminatory fashion.

11/ H.R. Rep. No. 98-934, 98th Cong., 2d Sess. 22, reprinted in 1984 U.S. Code Cong. & Ad. News 4655, 4659-60.

However, Congress should not have any hand in setting or mandating rates, terms and conditions for satellite-delivered programming. Such decisions should be left strictly to the marketplace. Genuine price competition, free of governmental involvement, is the best guarantor of consumer welfare. We believe that good faith efforts by program services to qualify independent distributors, and not to discriminate against any independents who meet the criteria, will inject much-needed competition into the marketplace.

2. The legislation should be sunsetted after an appropriate transition period.

It is important that the legislation be seen as bridging the gap for a short period of time until the TVRO industry becomes a full-fledged competitor in the marketplace. Therefore, it is essential that the bill be amended to include a specific sunset. Congress should not make the bill a permanent part of federal law. Congress erred once before when it gave the cable industry an open-ended compulsory license. It should not make the same mistake again.

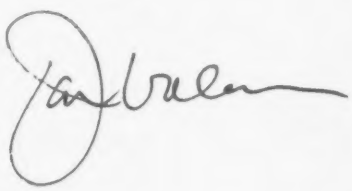
3. The bill must not compromise the absolute right of those who deliver programming by satellite to encrypt their signals.

When Congress passed the Cable Communications Policy Act of 1984, it specifically recognized scrambling as a permissible means to protect the integrity of satellite-delivered programming. Nothing should disturb this federally-conferred right to scramble. That would be especially detrimental to copyright owners.

Conclusion

Mr. Chairman, we look forward to supporting a bill that would inject real competition into the TVRO marketplace. We would be happy to work with you in the coming weeks to perfect the present bill. We also urge the relevant Committees in Congress to take a hard look at the myriad issues raised by the cable industry's growing domination of the marketplace.

Sincerely,



NATIONAL FARMERS UNION

August 3, 1987

The Honorable Daniel K. Inouye
Chairman
Subcommittee on Communications
Committee on Commerce, Science
and Transportation
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the more than 250,000 farm and ranch families who are members of the National Farmers Union, I am writing today in support of S. 889, the Satellite Television Fair Marketing Act of 1987. Rural residents across our nation rely on satellite communications to receive basic network television and added entertainment and news services that urban residents often take for granted. In addition, satellite communications offers a vast opportunity for rural development applications to assist rural communities in offering technologically advanced services. In order to remain competitive in terms of quality of life and services offered, rural towns can make effective use of satellite communications.

Sadly, traditional cable services offered in urban areas would simply be too costly for a rural application. Cost effectiveness is lost because of the great distances between farms and ranches. Satellite delivery of these services is a logical and cost effective alternative.

Today's satellite communications situation can be improved through the Satellite Television Fair Marketing Act. With the advent of satellite program scrambling, the number of services rural residents receive has declined significantly. During the past two years, 80 percent of satellite receiving equipment (dish) dealers and service outlets have gone out of business -- a figure directly related to the advent of program scrambling and the absence of alternative program delivery systems. Rural residents appear to be waiting for positive action on this front before making additional costly investments in equipment or repair.

We firmly believe that satellite programming originators have a right to be fairly compensated for their products. Rural residents want to pay a fair price to receive premium services. We

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support the National Rural Telecommunications Cooperative (NRTC) in its efforts to secure a fairly priced package of television services for rural American subscribers. NRTC will provide the service, collect the fee and pay the program source. In effect, NRTC has become the "cable company" for rural America.

We firmly object, however, to cable programmers' efforts to demand substantially higher fees from satellite viewers and the NRTC than from cable viewers for exactly the same programming. NRTC and rural residents at large must not be subjected to program fees that are as much as 700 times higher than fees for urban cable company subscribers.

Perhaps most importantly, satellite television offers a vast potential beyond its news and entertainment value. Satellite communications can be a valuable link between rural communities for shared information, rural development, and to foster competitive community services. Rural development efforts are being marshalled to improve rural schools and governments. Those efforts could be multiplied with the advantages offered by satellite teleconferences and specialized programming. A wide range of issues -- from waste water treatment technology to improved fire protection methods to shared school instruction for specialized classes -- can be covered in a cost effective manner through satellite communications. The potential will not be fulfilled unless local support and repair services are available for satellite receiving equipment. And that dream won't come true unless traditional programming is offered to rural dish owners at a fair price in order to support the dish equipment and repair industry.

Satellite communications is a technology with special application in rural America. The Satellite Television Fair Marketing Act provides needed support toward fulfilling the dream of sustainable, competitive rural communities.

Sincerely,

Robert A. Denman

Robert A. Denman
Director of Washington Operations

August 4, 1987

FEDERAL EXPRESS

Consumer Sub-Committee
Senate Committee on Commerce,
Science & Transportation
1st & Constitution, NE, Room 508-SD
Washington, D.C. 20510

Re: Proposed Legislation on Satellite Television Scrambling

Dear Senators:

I am the President of the National Satellite Programming Network, Inc. (the "Network"), a Texas corporation. The Network is a privately owned company whose principals reside in Texas, New York and New Jersey. I am writing to comment on the hearings conducted by the Telecommunications Sub-Committee on the scrambling of satellite television programming.

The Network is actively engaged in the marketing of satellite television programming to the satellite master antenna television ("SMATV"), multichannel MDS ("MMDS"), and TVRO markets. Essentially, the Network buys programming on a volume basis and resells it to smaller companies. The Network is the leading independent third party packager of television programming to the SMATV industry. We have over 400 companies as customers. In addition, we provide programming to SMATV systems we manage ourselves. The programming bought, packaged and sold by the Network reaches over 150,000 subscribers. The Network provides virtually all of the satellite television programming available to the cable television industry including such prominent services as Showtime, CNN, ESPN and the Superstations.

I am writing to bring the Committee's attention to two industry practices in the satellite television industry that have significantly hurt our business and stifled the emergence of SMATV, MMDS and TVRO as competitive alternatives to muncipally franchised cable companies. The first practice is that SMATV generally pays more than franchised cable for the same programming. This differential costs the Network several thousand dollars a month over the amount we would pay under a standard cable rate card.

1909 AVENUE G ▫ P.O. BOX 1489 ▫ ROSENBERG, TEXAS 77471-1489 ▫ 713-342-9655

We see no legitimate business reason why our SMATV programming rates should be higher than those charged to cable. It is well known in the programming industry that our particular company eliminates most if not all of the overhead costs incurred by programmers in dealing with SMATV companies. We built our business on putting together volume numbers of SMATV subscribers to achieve volume discount rates from satellite television programmers. Obviously, a programmer saves money by dealing with our organization and reaching a potential 150,000 subscribers spread out over 400 smaller companies than the programmer would otherwise spend by dealing with these companies directly. It is as economical for a programmer to reach the SMATV industry through a packager like the Network as it is for the programmer to reach multiple cable systems through a large multiple system operator. Nonetheless, even though the programmers deal with us and save money, we continue to pay more than cable for the same programming.

Some programmers defend the SMATV/cable price discrimination with the argument that SMATV and MMDS are somehow different from cable and therefore the programmer is exercising its commercial "right" to have different pricing schemes for "different" types of distributors. However, the only functional difference between SMATV/MMDS and cable is that cable distributes its programming by means of wires that use public rights-of-way and is therefore subject to municipal regulation. Why this difference should justify lower programming rates for cable eludes us.

The harsh reality is that all the satellite television programmers rely on cable for most of their subscriber base and therefore accord cable preferential treatment. The pernicious effect of this reliance is that alternative and competitive technologies such as SMATV, MMDS and TVRO--which have all been actively encouraged by the Federal Communications Commission--have been relegated to second class status by the programmers by virtue of being newcomers and without reference to their merits as a distributor. We respectfully ask the Committee to examine closely the satellite television programming industry practice of imposing higher costs on SMATV, MMDS and TVRO technology for programming and consider legislation which would remedy this discrimination.

We have found the antitrust remedies for this price discrimination to be unavailable. The cost of private antitrust action is prohibitive and we need the money to pay for the higher cost of programming.

Our other complaint about the programmers is their refusal to sell us TVRO rights. We put together a comprehensive plan to become an independent third party packager of satellite programming to the TVRO industry. Many of our customers are also engaged in the TVRO business and have access to that market. We also have ready access to the capital needed to undertake an independent packaging business. And most significantly, we are long standing customers of virtually all of the major programmers and are experienced in the independent programming packaging business.

Notwithstanding these credentials, we have been consistently rebuffed by all the programmers, with the exception of Turner Broadcasting, in our attempts to become involved in the TVRO programming business. We note that many of the programmers engaged in marketing TVRO rights have, to one degree or another, allowed their municipally franchised cable customers to engage in packaging and selling TVRO rights to the programming. Again, as with the price of the product, we have been discriminated against by the programmers who have refused to extend to us the same kinds of TVRO packaging rights that they have extended to their cable television customers.

We ask the Committee to examine this practice closely and draft legislation which would require programmers who elect to use independent packagers as distributors to refrain from discrimination which favors a municipally franchised cable television company.

I regret being unable to testify at the hearings on July 31 although we asked to be included. If you or members of your staff have any questions regarding our business operations or any of the items discussed in this letter, I would be glad to be of assistance to you.

Sincerely,

R. L. Vogelsang

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